

# Estate Planning

## Transferring Property to Your Heirs



## **Estate Planning: Transferring Property to Your Heirs**

Planning ahead to ensure your family is taken care of after you die is one of the most important things you can do. Develop a comprehensive estate plan to ensure orderly distribution of your assets, protect minor children, prepare for potential incapacity, and avoid costly probate fees and estate taxes. Certain payments and benefits will be available to your survivors, and it's up to you to ensure they know how to apply for these programs and where to find answers to their questions. Call MOAA at (800) 234-MOAA (6622) or email [beninfo@moaa.org](mailto:beninfo@moaa.org) if you have questions or need clarification.

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# Introduction

Developing a coherent estate plan for the orderly distribution of your assets and the protection of minor children, planning for potential incapacity, and avoiding unnecessary — and costly — probate fees and estate taxes are key components of financial planning.

Everyone — whether married or single, with or without minor children, multimillionaires or those of more modest means — should have at least a basic estate plan drafted by a skilled estate-planning attorney. Once in place, the plan should be reviewed periodically (at least every five years) or anytime a major life event occurs, including:

- marriage/divorce/remarriage;
- the birth or adoption of a child;
- a substantial change in financial assets;
- moving to a new state; or
- retirement.

You also should consider your children's and grandchildren's statuses. Proper estate planning also requires reviewing all of your assets and being aware of the appropriateness of your insurance needs (such as life and long term care), IRAs, Roth IRAs, 401(k) plans, and 529 plans. Depending on your particular needs and the size of your estate, an estate-planning team involves an insurance agent, a financial advisor, an accountant, and a lawyer.

To dive deeper into any issues discussed in this guide, download and fill out the MOAA *Personal Affairs Action Guide* workbook at [www.moaa.org/infoexchange](http://www.moaa.org/infoexchange) for additional information.



Although there are do-it-yourself estate-planning kits available online and in bookstores, a small mistake or improper wording can be very costly. Therefore, the help of a competent estate-planning attorney often is critical to ensuring a valid and effective plan.

# Chapter 1

## The Basics

### WILLS

The basic building block of any estate plan is a will. At the simplest level, a will determines who receives your assets after death and nominates an executor (or a personal representative) to ensure your assets are distributed according to the terms of your will. If you have minor children (under the age of 18), a will also is used to appoint a guardian for those who have not yet reached the age of majority at your death. In addition, a minor's trust usually is included to handle any assets inherited by an underage child. A minor's trust designates a trustee to control the assets (using them for the benefit of the minor) until the minor turns 21.

### LIVING WILLS

The living will (also known as a medical directive or an advance health care directive) is a declaration of what medical care and procedures you do or do not want should you become incapacitated because of an injury or illness. It often specifies do-not-resuscitate instructions and covers such items as removing life support if your incapacity results in a persistent vegetative state.



When a person dies without a valid will established, it is called “dying intestate,” and it is considered a terrible way to pass property. Property is distributed according to state law, and the courts will appoint executors and guardians, as needed, at considerable potential expense to the estate.



## HEALTH CARE POWER OF ATTORNEY

This document, alternatively called a designation of health care surrogate or patient-advocate designation, nominates someone to make medical decisions on your behalf if you are unable to communicate with your medical team. Many states now are combining the living will and health care power of attorney into a single document.

# Chapter 2

## How Assets Transfer

### PROBATE

Probate is the process of proving a person's estate—legally filing and validating a person's will with the court system, identifying and valuing property, paying off debts, and distributing assets. Although many states have taken steps to simplify the probate process in recent years, it still can be time-consuming and expensive.

### OPERATION OF LAW

However, many assets pass by operation of law outside of probate, including:

- **Assets With Beneficiary Designations:** Virtually all assets with beneficiary designations — such as life insurance, annuities, IRAs, and other retirement accounts and pension plans (such as 401(k) plans) — bypass probate and are distributed to the designated beneficiaries.  
**Exception:** If the beneficiary is the deceased person's estate, these assets are subject to probate.
- **Assets With Payable on Death (POD) or Transfer on Death (TOD) Designations:** POD (used for bank accounts and certain government securities) and TOD (used for brokerage and securities accounts) allow assets to bypass probate. They might not be available in every state.
- **Jointly Held Assets:** Assets with joint tenancy, tenancy by the entirety, and community property with right of survivorship (check whether available in your state) titling usually pass outside of probate.
- **Living Trust:** Assets retitled into a revocable living trust are distributed by the trust provisions and generally not subject to probate. They still are subject to applicable federal or state inheritance taxes. (A trust must be irrevocable to avoid the taxable estate.)



Tenancy by the entirety is limited to married couples, and it is not available in every state.





Marital property ownership rules can be very confusing. If you relocate to or from a community property state, ensure you understand the rules completely so you don't get blindsided.

## COMMON LAW VERSUS COMMUNITY PROPERTY

Most states are common-law states. However, nine states are community-property states. Marital property ownership is handled differently under these two systems. (See “Understanding Community Property,” below, for more information about community property states.) In common-law states, property ownership generally is determined by asset titling, regardless of who purchased the asset.

## UNDERSTANDING COMMUNITY PROPERTY

To find out what is considered community property, consider the following information.

- **Community Property States:** Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.
- **Community Property Includes:** all income received by either spouse through employment or other means while married (except for gifts or an inheritance by one spouse), assets purchased with community property income, and separate property comingled.
- **Separate Property Includes:** property owned by either spouse prior to marriage, property inherited or gifted solely to one spouse during marriage, and property earned solely by one spouse after permanent separation.

# Chapter 3

## Living Trusts: Pros and Cons

A trust is created to separate certain assets you want to have invested, held, and distributed to accomplish different objectives, such as tax benefits, protection of assets, and other needs. Trusts can be irrevocable or revocable as in a revocable living trust. Another trust that often is required is a special-needs trust (sometimes called a supplemental-needs trust), where assets are held for a person with mental or physical disabilities so they are not counted against eligibility for Social Security benefits, Medicaid coverage, vocational rehabilitation, and subsidized housing.

### WHAT IS A REVOCABLE LIVING TRUST (RLT)?

An RLT is a flexible legal document that controls the transfer of property retitled into the trust. The person who sets up the trust is called the grantor (or trustor or settlor). Assets retitled into the trust become trust property (also called trust principal). The trust document designates a trustee who controls the trust property. (Most RLTs also name a successor trustee who takes over as trustee after the grantor's death.) The people or organizations (such as charities) that will receive the trust property after the grantor dies are called the beneficiaries of the trust. While the grantor is alive, he or she often is both the trustee and beneficiary of the RLT. If a married couple sets up a joint trust, both are considered grantors.

### POTENTIAL RLT BENEFITS

Do you need an RLT document? Consider using an RLT if you:

- live in a state with high probate fees or a complicated probate process. In such states, RLTs can provide significant cost savings to the estate;
- own real property in more than one state. Retitling out-of-state real estate into an RLT avoids potentially costly and time-consuming ancillary probate, because real estate must be probated in the state in which it is physically located (This is a prime reason for using RLTs.);
- value privacy protection. RLTs are private transfers, while probate is a public process;
- want to plan for mental or physical incapacity; or
- are not legally married to your partner. RLTs are key planning tools for unmarried and some same-sex couples.



## POTENTIAL RLT DRAWBACKS

RLTs are powerful estate-planning tools, but they aren't for everyone. Some drawbacks of RLTs include:

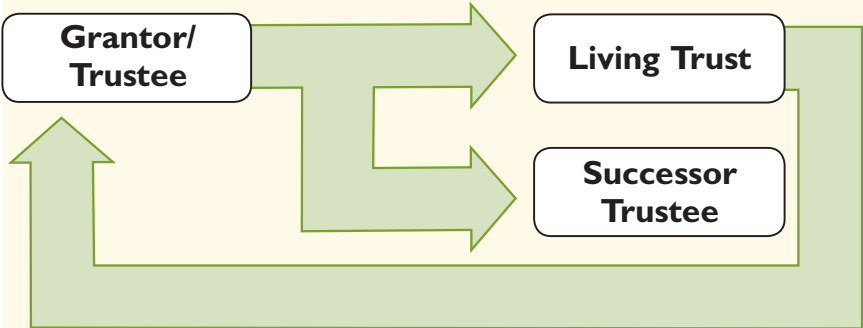
- **Cost.** Having an RLT drafted can cost thousands of dollars, depending on the complexity.
- **Security.** There are fewer protections from creditors, bankruptcy, and lawsuits in some states.
- **Time.** Assets must be retitled or transferred into an RLT. This is a time-consuming but necessary step (otherwise, the RLT is useless).

## HOW A REVOCABLE LIVING TRUST WORKS DURING GRANTOR'S LIFE



1 Grantor creates trust, names successor or cotrustee, and transfers assets to trust.

2 Trust owns transferred assets and distributes income and assets according to trust agreement. Grantor remains responsible for taxes.

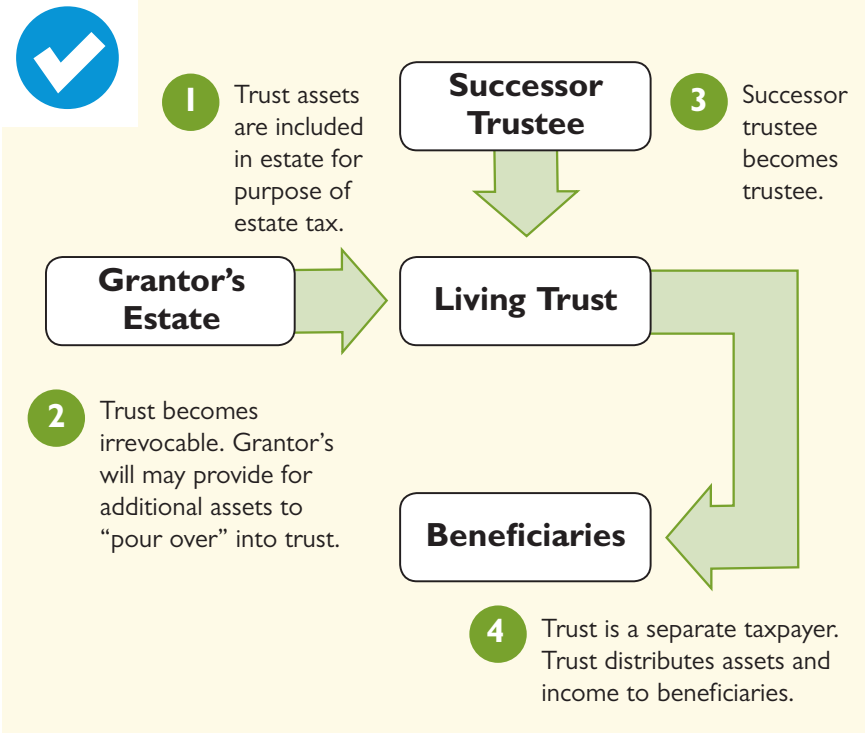


3 Successor or cotrustee steps in to manage trust assets if grantor becomes incapacitated but can't amend or end the trust.

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- Updates.** RLTs needed to be reviewed and (potentially) updated on a routine basis as you move to another state, acquire other property that should be placed into the trust, refinance or sell trust property, or have a major life change (divorce or remarriage, death or incapacity of a beneficiary, or death or incapacity of a trustee or a successor trustee).
- Taxation.** Upon the grantor's death, if an RLT holds income-producing property, it must obtain its own tax ID number and file appropriate federal and state returns at a high tax rate.

## HOW A REVOCABLE LIVING TRUST WORKS UPON GRANTOR'S DEATH



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# Chapter 4

## Special Situations

### DIVORCE OR REMARRIAGE

Failing to update a will or a revocable living trust after a divorce or remarriage can create significant problems in estate settlement, while failing to update beneficiary designations on life insurance, annuities, and IRAs or other retirement plans can be devastating financially to your new spouse. If you want your assets available to support a second or subsequent spouse — while ensuring your children from a previous marriage ultimately will receive the assets — you'll have to plan ahead with the proper trust arrangement.

### SPOUSES WHO ARE NOT U.S. CITIZENS

While asset transfers (either through gift or estate transfer) between spouses who both are U.S. citizens have an unlimited marital shield, transfers to a spouse who is not a U.S. citizen from a spouse who is a U.S. citizen are extremely limited. To leave more than the current estate-tax exemption to a spouse without paying estate taxes, special trust arrangements must be used.

### UNMARRIED AND SAME-SEX COUPLES

Unmarried couples can't legally inherit property from each other in most states without additional estate planning. Well-crafted revocable living trusts, transfer on death and payable on death designations, and joint property ownership all are critical planning tools. Same-sex couples also might have challenges. Because of the June 2013 Supreme Court ruling on the Defense of Marriage Act and Proposition 8, check the requirement within your state.

# Chapter 5

## Lifetime Gifting

Making personal or charitable gifts in your lifetime can help you reduce the size of your estate while supporting people or causes you care about.

### ANNUAL GIFT-TAX EXCLUSION

Everyone can gift up to the gift-tax exemption limit annually to any individual without tax consequences or filing paperwork. This is a “per donor, per donee” limit, so a married couple could give up to twice the amount when adding together the individual annual exemption amounts. Visit [www.irs.gov](http://www.irs.gov) for the latest annual exemption amounts.

### CHARITABLE TRUSTS

Using a charitable trust, such as a charitable remainder annuity trust, a charitable remainder unitrust, or community foundations/donor-advised funds, is an excellent way to secure a lifetime income stream while reducing estate taxes and getting a significant income tax deduction. Visit [www.moaa.org/scholarshipfund](http://www.moaa.org/scholarshipfund) to find out how to support the MOAA Scholarship Fund.

### DIRECT PAYMENTS TO HOSPITALS AND HIGHER EDUCATION INSTITUTIONS

Payments made directly to hospitals and universities on behalf of someone else are exempt from the annual gift-tax limits and don't require filing a gift tax return.



# Chapter 6

## Life-Stages Checklist

It's important to update estate plans when major life events occur and periodically to ensure their accuracy. The simple checklist below covers some of the most common reasons to update or change an estate plan.

	Single	Married	Married with Children	Special Situations (unmarried couples, divorce, remarriage)
Basic estate plan.	●	●	●	●
Consider updating your estate plan when you relocate to a new state or have a major life change (birth, death, divorce, remarriage, or retirement) or every five years.	●	●	●	●
Add your spouse to asset titles and change beneficiary designations on life insurance and retirement plans.		●		
Revise your will to include guardianship provisions and minor's trusts.			●	
Consider adding a revocable living trust to your estate plan as assets grow if you live in a high-probate-fee state or own out-of-state property.			●	
Revise your estate plan for special circumstances. (Common mistakes include failure to change beneficiary designations from a former spouse to a current spouse after a divorce.)				●

# Summary

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Estate planning doesn't need to be terribly complex for most situations, but a carefully crafted plan that is reviewed and updated every five years is essential. To help organize your finances, property, and personal life, download the MOAA *Personal Affairs Action Guide* workbook at [www.moaa.org/infoexchange](http://www.moaa.org/infoexchange). Visit [www.moaa.org/lawyerlist](http://www.moaa.org/lawyerlist) find a lawyer who offers discounts to MOAA members.

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