ESTATE PLANNING IN LOUISIANA FOR THE MIDDLE CLASS

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WHAT IS ESTATE PLANNING?

Estate planning comprises three aspects:

A. *Accumulating wealth*. Wealth is created by earnings, investment returns, and, in some cases inheritance. For most of us, significant wealth and a comfortable retirement can be achieved only by sensible investing.

B. *Protecting wealth*. Life insurance is necessary in case of premature death. Disability insurance protects earning power. Usually overlooked is *asset protection planning* -- arranging your financial affairs so that in the event of a large judgment against you or bankruptcy you will survive with assets not reachable by your creditors. This involves investing in exempt assets (e.g., life insurance, retirement plans, and IRAs) and establishing family partnerships, corporations, or limited liability companies. Asset protection planning also means making sure that whatever you transfer to your heirs is protected from their potential creditors.

C. *Disposing of wealth*. This involves planning to pass your assets on to your heirs either while alive or at your death and is the meaning that most often comes to mind when the term estate planning is used. Estate planning can be extremely complex, even for relatively modest estates, and includes aspects of the laws of successions, real estate, community property, Medicaid and federal tax law. Poor estate planning can result in a large and unnecessary federal estate tax, as well as a number of other problems. For smaller estates, Medicaid planning is an important consideration.

FORCED HEIRSHIP

Forced heirship is seldom a problem in Louisiana, nor was it before the

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change in the law to redefine forced heirs to exclude adult children. Appendix A treats forced heirship in some detail.

Why You Need a Will

A. Hard feelings and squabbling can occur among your survivors without solid direction from you.

B. If you do not specify how your property will be distributed, Louisiana will do it for you as follows:

1. *Community property.*

    a. Your one-half share of community property goes to your descendants, not your spouse, but it is subject to the usufruct of your spouse until death or remarriage, meaning your spouse has the right to the income from the property and the right to use it.

    b. Your children, especially from a previous marriage, could force your surviving spouse out of the house if he or she remarries and force the partition and sale of any other community property.

    c. Your spouse will also lose the income stream upon remarriage and will have to pay back any cash he or she has expended from your share of the community property (not the income, but the original cash). If your spouse has made improvements to property, such as the house, your children will not be required to reimburse him or her for those improvements at the termination of the usufruct.

    d. Children from a previous marriage, if they qualify as

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forced heirs, can force your spouse to post security for their portion over which the usufruct attaches. As to separate property, even children of the marriage who are forced heirs can force their surviving parent to post security to the extent of their forced portion. Insurance companies do not sell bonds to usufructuaries, so your spouse will need to find some other source to cover the bond, if possible. Expensive litigation could ensue to set the amount of the bond (which could exceed the value of the property subject to the usufruct) or to establish an acceptable alternative.

e. Usufruct over cash gives your spouse the right to spend it, subject only to an obligation to repay upon the termination of the usufruct. There may be nothing left for your children by then. (Some people find this desirable. Others write their wills to avoid it. If a goal is to protect the interests of your children, usufruct is a poor choice. A trust, discussed below, will work much better.)

2. *Separate property.* All separate property goes to your children in full ownership. If you have no children, your brothers and sisters and parents inherit your separate property. If they don't survive you, your nephews and nieces will inherit. Your spouse gets nothing, not even the usufruct. Only if you leave no descendants, parents, or siblings or their descendants will your spouse inherit your separate property.

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C. Changes you can provide in your will.

1. Confirm the usufruct for life – over all or a portion of your assets (e.g., the family home), over separate as well as community property. You may also specify that your spouse can sell the property without the concurrence of your children (with certain exceptions noted in Appendix A). You may also specify that if the property is sold the usufruct attaches to the cash proceeds, which results in your spouse being able to spend the cash freely without having to pay it back until death.

2. Dispense with usufruct–on the other hand, you may specify that your spouse receives no usufruct at all, in which case your heirs inherit in full ownership.

3. Place the forced portion into a trust so your spouse can sell the property without the concurrence of your children and without requiring a tutorship proceeding and court approval for sale by minor children, and so forced heirs from your previous marriage (or from your current marriage as to separate property) cannot force your spouse to post a bond.

4. Place the bulk of your estate into a trust to protect your heirs, as discussed in detail below.

D. Controlling your children from the grave.

1. Property inherited by a minor child is controlled by his tutor (guardian).

2. At age 18, the child gets full ownership of the property (unless burdened by a usufruct). Few 18 year olds are

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responsible or wise enough to handle a significant inheritance.

3. In your will, you can establish a trust (referred to as a "testamentary" trust because it is created in your last will and testament) to control when your children will get possession of their inheritance. A responsible trustee can invest the property and can be given great discretion in distributing income and principal to the children on an as-needed basis. You may specify in the trust that the older the beneficiaries of the trust become the more lenient the trustee will become in making distributions.

E. Other uses for trusts.

1. *Protect your children's inheritance*. <u>One of the most important uses of a trust</u>. The major concern for many people is that if they leave their entire estate to their spouse, the spouse may leave little or nothing to their children. (This is particularly a concern in second marriages, but can be just as valid in first marriages.) This concern can be alleviated by placing some or all of your estate in trust, with your spouse receiving whatever share of the trust you deem appropriate (such as income only), and the rest going to your children at your spouse's death. With your property in trust, your spouse cannot control its disposition in his or her will.

2. *Professional management*. A trust can assure professional management of your estate and guaranty that something will be left for your children, whereas if your estate is not placed in trust your surviving spouse's new husband or wife may have other ideas on how the money should be spent or may

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invest it unwisely.

3. *Charitable trusts*. A charitable trust can be established, with your spouse and/or heirs receiving an annuity and the charity receiving the remainder. In certain circumstances, such a trust will generate significant tax benefits.

4. *Class trusts*. A class trust will allow you to provide for beneficiaries who are not born at the time of your death, specifically your children, grandchildren, great grandchildren, nieces and nephews, grandnieces and grandnephews, or great grandnieces and great grandnephews (or any combination of them), so long as any one member of the class is alive when you die. There is no other way you can leave property to unborn persons.

5. *Impinge on forced portion*. A trust can be used to impinge on the forced portion of your children by allowing your spouse to be income beneficiary for life. If you have remarried, and your spouse is relatively young, your children may never see their forced portion, so you may not want to do this. (A lifetime usufruct in favor of your spouse can also impinge legally on the forced portion, but with much less flexibility.)

6. *Marital portion in trust*. If you die "rich" in comparison to your spouse (which would happen only if you own a substantial amount of separate property), your spouse has, in effect, a right to a forced portion of your estate (up to $1,000,000):

   No children - ¼ in full ownership

   1 to 3 children - ¼, usufruct only

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More than 3 children - a child's share, usufruct only

In your will you can provide that the marital portion, if any, be put into trust with your spouse as income beneficiary only, thus assuring that your children will receive the principal upon your spouse's death.

Life insurance can be used to satisfy the marital portion, just as it can be used to satisfy the forced portion.

7. *Tax effects*. A trust can minimize federal estate taxes (but so can usufruct).

8. *Avoiding creditors*. If you anticipate problems with creditors, you <u>may</u>, under certain circumstances, donate property to a trust for the benefit of your children, or even your spouse, and insulate the property from your creditors. You may not yourself, however, be a beneficiary of the trust.

9. *Avoiding your children's creditors*. An extremely important consideration when writing your will is to protect your estate from your children’s creditors. If any of your children or other heirs have financial problems, it would be foolish to leave them their inheritance outright so their creditors can seize it. Instead, put their share in trust where it will be insulated from creditors. Except as discussed below, this protection does not extend to federal taxes, alimony and child support, or, in Louisiana and some other states, personal injury awards. Therefore, the trust should have a “flight” clause which allows the trustee to transfer the trust to a more favorable jurisdiction, such as Texas, Alaska, or certain foreign countries with more protective trust laws, if it appears

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that a creditor is about to close in on a beneficiary.

If you have full confidence in your children, you may even name them as co-trustees, creating a “beneficiary controlled” trust. Your children will have access to trust funds, without the need to go through a third party trustee, but creditors will not have access. This is like setting up a protected investment account for your children.

10. *Protecting your heirs from potential nursing home costs*. If any of your children are disabled and qualify for governmental benefits, such as supplemental security income or Medicaid, you must leave his or her share in trust. Also, consider that your heirs may have problems in the future, such as Alzheimer disease, brain damage from an accident, or frailty with old age, that may indicate a need for governmental benefits. However, if their inheritance is not in trust, they will not qualify for aid until having spent down the inheritance, essentially wasting it.

F. *Administration of your estate*.

1. You need to appoint an executor to assure that the person of your choice will handle your estate. It is surprising how often heirs fight over who will be in charge.

2. You can specify that your executor be “independent,” meaning he or she will not need to obtain court permission to act. If the estate representative is not independent, the administration of your estate may be slow and more expensive. For example, if the executor is not independent, it will take at least 30 days for the executor to sell real estate,

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with court approval. If independent, the executor can act immediately to sell real estate.

3. If you have no will, the administrator of your estate may have to put up a bond of up to 1¼ times the value of the estate. Insurance for a bond is expensive and the premium must be paid by the estate. In your will, you can waive the bond. This factor alone is reason to write a will, even if your estate is very small.

4. You can specify that the executor serve without compensation. If the executor is unwilling, he need only refuse to serve and let someone else have the job. On the other hand, you may prefer to set an amount or a percentage of your estate to compensate the executor.

G. *Appointing a tutor (guardian)*.

1. In your will you can choose the tutor (the Louisiana term for guardian) for your minor children (assuming their other parent has predeceased you or is unable to care for the children). This can also be done by a separate document that is not a part of your will.

2. This prevents arguing among family members and assures that your desires are followed.

3. You may also want to provide compensation for the tutor so that his family can raise its standard of living commensurate to that of your children. For example, the tutor may need to purchase a larger home or add on to his or her current home. This money may also allow the tutor to afford vacations that you would want your child to have (the tutor can't spend your child's money on his own share of the vacation expenses). In

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your will, you will need to clearly set out the compensation of the tutor, or the tutor will not be entitled to compensation.

H. *Appointing an attorney for your estate and the testamentary trust*. Your attorney is more familiar with your affairs than the attorney that may be selected in the absence of your guidance. Therefore, you may want to name an attorney for your executor. However, this designation is not binding. The Louisiana Supreme Court has ruled that the attorney works for the executor, not the decedent, and the executor has an absolute right to pick his own attorney. If you have strong feelings about your attorney handling your estate, it will be necessary to name your attorney as executor.

I. *Minimizing and deferring estate taxes*. If you do not have a large estate, go ahead and skip this section. If your family estate is worth more than $5,450,000 (as of 2016), *<u>including life insurance proceeds</u>*, dying without a will can result in the payment of unnecessary estate taxes. If your share of the estate is over $5,450,000, and presuming you die before your spouse, estate tax will be due at your death, where with a will it could be deferred until the death of your spouse. The estate tax rate for value in excess of $5,450,000 is 40%.

This is yet another instance place where a cheap will may be worse than no will at all. Many couples get “simple” wills, with each leaving everything to the other. The estate of the first spouse to die will pay no estate tax, regardless of the size of the estate, because of the unlimited marital deduction. However, this estate will may in some cases not allow the use the deceased spouse’s $5,450,000 exemption. If so, when the second spouse dies, she will be entitled

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to only her exemption, and the first spouse's exemption will have been wasted. (Under a "portability" provision, the surviving spouse may use the first spouse's exemption, but this benefit has conditions that are often not met.) The additional tax to the children could be as high as $1,750,000 for a large estate.

A simple example illustrates how this can happen. Assume that a husband and wife had an estate of exactly $10,900,000, all of which was community property, and that the husband died in 2011. In his will he left everything to his wife. At the wife's death, her estate pays unnecessary tax of $2,117,800 because the husband's estate is not able to use the exemption. (Under the new law, under the portability provision the husband's unused exemption may be used by the wife's estate in most circumstances, but exceptions may prevent this, such as if the wife remarries.)

	Husband	Wife
Value of estate	$5,450,000.00	$5,450,000.00
Marital deduction for husband's estate	($5,450,000.00)	
Exemption	-0-	
Husband's taxable estate	-0-	
Gift from husband		$5,450,000.00
Wife's total estate		$10,900,000.00
Exemption		($5,450,000.00)
Wife's taxable estate		$5,450,000.00
Tax	-0-	$2,117,000.00

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Now assume that the husband's will left his half of the estate to a credit shelter trust (one whose purpose is to shelter the full exemption amount from tax in both estates). His wife is the income beneficiary for life and has the ability to invade the principal of the trust if she runs low on cash and the income from the trust is not enough. The right to invade the principal is not unlimited, but must be for her "health, education, maintenance or support." The children are the principal beneficiaries, but they will receive nothing until the wife dies. The wife may be the trustee (and usually is). (Also assume that portability does not apply because the wife has remarried.)

	Husband	Wife
Value of estate	$5,450,000.00	$5,450,000.00
Marital deduction for husband's estate	-0-	
Exemption	($5,450,000.00)	
Husband's taxable estate	-0-	
Gift from husband to wife		-0-
Wife's total estate		$5,450,000.00
Exemption		($5,450,000.00)
Wife's taxable estate		-0-
Tax	-0-	-0-

Planning for estate taxes is extremely complicated, but it can save your family hundreds of thousands of dollars if you are wealthy. Without a carefully drafted will, you heirs may be stuck with just paying the tax.

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J. You need to review your will periodically and revise it as your situation and desires change, or to accommodate changes in the law.

The Dangers of a Simple Will

A. *A blunder?* Many clients believe that they need a simple will. A simple will is easy to understand, it is short, and it is less expensive than a more complicated will containing a trust. Unfortunately, a simple will is usually a simple blunder.

B. *Control of ultimate disposition of your estate*. A simple will does not usually allow you to control the ultimate disposition of your assets! For example, most of us who are married want our spouse to have everything at our death and our children to receive whatever is left when our spouse also dies. As explained above, this can have disastrous tax consequences. But much more important, this could cause your estate to end up in the wrong hands. Your spouse may change his or her will after your death to leave the entire estate, including your one-half, to children from a previous marriage, to his or her new spouse, to children who may be born of the new spouse, or to any number of persons or organizations other than your children. Your spouse may become old and confused and end up leaving everything to a housekeeper or a church of which you do not approve.

You can prevent this unpleasant possibility by not leaving your entire estate directly to your spouse. This is an extremely important advantage of the judicious use of a trust in your will, and for most clients the single most important reason to write a will that contains a trust. For example, many couples write their wills to leave to each other all of their household property, vehicles, and similar items, but

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leave the balance to a trust for the benefit of the spouse as income beneficiary, usually for life, and the principal or remainder interest to the children. The surviving spouse will then not be able to dispose of the deceased spouse’s assets in his or her will because the property in trust belongs to the children, not to the surviving spouse. The survivor will have the benefit of the trust property while alive, but will not be able to dispose of the principal. If the surviving spouse is named as trustee, he or she will even have control of the trust property. The surviving spouse may even be given the right to invade the principal of the trust if necessary for health and support after running out of his or her own cash and other liquid assets.

In the great majority of cases, such an arrangement works out very well, imposing little on the surviving spouse but protecting the interests of the deceased spouse’s children. However, the concept of a trust is so unusual that most people do not really comprehend it until the trust has been in place and operating for awhile; consequently a trust can be the source of anxiety for the survivors until they have the time to become comfortable with it. Furthermore, the use of a trust presents its own issues, such as who to name as the trustee. Often the surviving spouse is not ideal. Aside from obvious reasons in some cases, such as not having the required level of competence and judgment, the spouse may not want to provide annual accountings to the children, and in some cases there are no relatives who are ideal.

Some appoint a bank or a trust company as the trustee, although these estates must be large enough to justify the trustee’s fee.

A majority of my clients will name one or more of their children as

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either original co-trustees or as successors to the spouse. This has the advantage of keeping all issues within the family, but in a significant percentage of cases this does not work out well. Ths option is discuss more fully below.

C. *Medicaid planning*. A simple will fails to provide any Medicaid planning provisions. Property left in trust can be eliminated from consideration as a resource for any beneficiary applying for Medicaid or other governmental benefits – if the trust contains the proper provisions prohibiting the trustee from making expenditures for any item that Medicaid or some other governmental program will cover. We have all heard stories of how family estates have been decimated by nursing home costs and other expenses not covered by Medicare or health insurance. Because Medicaid is a welfare program, it covers only the poor, requiring that a person have no more than $2,000 of available resources (plus limited exempt assets) in order to qualify, forcing the person to expend all of his assets before the state will pick up the tab for the nursing home. A trust can preserve the deceased spouse's share for the children and provide extra items or special needs for the surviving spouse from cash that would otherwise pay for nursing home care.

D. *Asset protection*. A simple will also provides no asset protection for your heirs. For example, if your will leaves everything to your spouse, and after your death your spouse is at fault in an automobile accident, your estate, now in the hands of your spouse, may end up paying the judgment. If, however, you had written a more complicated will that left the majority of your assets in trust, none of your assets would be in jeopardy. A well drafted trust would contain a "spendthrift" clause that would protect the assets to the greatest

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extent allowed by law, which means the trust assets would be safe.

A simple will would also provide that when both you and your spouse died all assets would go immediately to your children. But what if one of your children were bankrupt at that time? His inheritance would be lost to creditors. On the other hand, if your will contained a provision that would require a child's share to remain in trust, his inheritance would be preserved in the trust.

Many people, after fully considering the advantages of a trust, write their wills to state that when both the spouses are dead their assets will remain indefinitely in trust for their children or other beneficiaries, regardless of their ages. If the parents do not want a bank or trust company to serve as trustee of a trust for their adult children, the children can be named as trustees upon attaining a specified age, such as 30. In that case, the children would be in charge of their own trust and could be as generous with themselves as they desire, but with the assurance that the money they do not need at the time – the portion that will remain invested – will be guarded within the trust against any future creditors or predatory spouses.

Life is extremely complex, and a simple will cannot adequately provide for many of the common complications that arise during the lives of most families. Few documents you execute will be as important as your will, and drafting it should not be taken lightly. Even for small estates it is not a do-it-yourself project.

LIVING TRUSTS

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A. *Background*. Scores of authors have written books on the topic of living trusts, and magazines have featured living trusts in hundreds if not thousands of articles. Some law firms of dubious ethics send out teams of salespeople to knock on the doors of the elderly and convince them that they simply cannot die until they have signed a living trust. Many of these peddlers are assisted by financial planners who very graciously agree to manage the client's portfolio once the trust is set up. (Many states are cracking down on these schemes.)

The peddlers of living trust kits tout the avoidance of probate as the primary benefit of a living trust. And probate, they tell us, absolutely must be avoided in order to escape the outrageously high fees charged by probate attorneys and the agonizing, drawn out probate process. These peddlers further lead one to believe that a living trust can minimize estate taxes whereas a will cannot.

Most of this is exaggeration and plain distortion, sometimes outright fabrication. Living trusts, although seldom harmful, are not needed by everyone. Probate is seldom the evil it is portrayed to be, and probate costs are usually reasonable. Furthermore, although a well drafted living trust can go far to minimize federal estate taxes, it can do no more in this respect than a well drafted will.

B. *Reality.* Following is a realistic assessment of living trusts.

1. *The basic function of a living trust*. A living trust should allow the decedent's estate to avoid probate. Why is this? How does it work? Consider first the primary purpose of probate or succession–to change the name on the title to the decedent's assets. When a person dies, his property is still in his name. For example, his name is on the deed to his home

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and the title to his car. It is on his investment and bank accounts. No one, not even the surviving spouse, can just declare that title has changed merely because of the person's death. (Of course, some assets, such as life insurance, will be transferred merely by proving a person has died, and some assets do not need to be transferred at all in order for the heirs to gain access, such as joint bank accounts that allow the surviving co-owner to freely access the funds.) Every society has established laws to govern the succession of a person's property to his heirs. In many countries, this process is called probate or succession. A succession requires the filing of certain papers with the court, including the will, if any; an inventory; an affidavit stating who the person was and who his family members are, and so forth. A succession typically ends with the judge signing a *judgment of possession* that officially transfers title of a person's assets to his heirs and legatees. (A legatee is a person who is named in a person's will to receive a bequest.) The judgment of possession is filed in the conveyance records. For real estate, it operates as a deed showing who the new owners are. For investment accounts, it officially identifies the new owners for the bank or broker.

With a living trust, a person changes the title on his assets while he is still alive. At his death, he has no assets titled in his own name that would have to go through the probate process, thus avoiding probate or succession proceedings.

2. *Establishing and administering the living trust*. A living trust takes effect as soon as you sign and fund it, unlike a

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testamentary trust that does not come into existence until you die. At the same time that you sign the living trust instrument, you sign documents to transfer nearly all of your assets to it, such as a deed for real estate, and acts of transfer for vehicles, investment accounts, etc.

You and your spouse serve as trustees, and you are the only beneficiaries of the trust as long as you are both alive. Should either of you become incompetent, the other will serve as sole trustee. No bank will have any authority over the trust, unless you name a bank as trustee. If you both die or become incompetent, the successor trustee will be whomever you name, often one or more of your children, sometimes as bank or a trust company.

While both of you are alive the trust has little substance. It is as if you had merely started using an alias because you have full control over all of the trust assets. If you want to withdraw cash from the trust, you simply write a check, just as you do now. If you want to sell an investment, you simply tell your broker, just as you do now. You may amend or even revoke the trust at any time you desire.

When one of you dies, one or possibly two new trusts spring from the living trust, and some or all of the decedent's share of the trust assets are transferred to this new trust (usually referred to as the "decedent's trust.") The surviving spouse's share of the trust property remains in the living trust. The decedent's trust is irrevocable, just as a testamentary trust.

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3. *Tax benefits*. The tax benefits of a living trust are no more and no less than the benefits available from a well drafted will. A living trust will establish a credit shelter trust (discussed above), and perhaps a marital trust, just as a testamentary trust will do. If anyone tells you differently, they are misinformed or dishonest.

4. *Benefits after your death*. After your death, your share of the trust becomes irrevocable and separates from the original trust. Your spouse's share remains in the original revocable trust. The then irrevocable trust will accomplish whatever directives you set out in the trust instrument. For example, it may provide for full asset protection benefits, special needs for a disabled beneficiary, directions on when distributions are to be made to the beneficiaries, and so forth.

5. *Costs and advantages*. Setting up a living trust and transferring all of the appropriate assets to it is more time consuming that drafting a will that contains a trust, and the attorney fees are correspondingly higher. It is not unusual for a living trust and all the collateral documents to cost up to $6,000 or more. Simple cases cost less, and complex cases may cost much more. (Of course, a complex case will entail a larger fee even if a living trust is not chosen.) Many people like the idea of a living trust but are not willing to pay the additional fee to establish one.

   The costs of establishing a living trust will be at least partially offset by the avoidance of probate at your death. However, many of the fees that are typically incurred in probate are also

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incurred after death even if a living trust is used. For example, fees will be incurred for attorney and accountant consultations for post mortem planning, for the preparation of an estate tax return for large estates, and for appraisals. Many families also need detailed guidance about administering the trust.

In Louisiana, unlike some states, attorney fees for probate are usually billed by the hour or at a reasonable flat fee rather than as a percentage of the estate. This is much fairer for the client. As a result, attorney fees for probate are usually quite reasonable, barring complications, and the avoidance of probate costs is seldom a significant advantage of a living trust.

However, avoiding probate does have the advantages of privacy and the avoidance of delay. In a succession proceeding, an inventory of the decedent's estate must be filed in the public records, which is open to anyone who is interested in looking. Most of us do not relish the thought of our neighbors and salespersons reviewing a detailed list of what our estates will involve, although many of us couldn't care less. Additionally, even simple estates may spend several weeks or months in the succession process. With a living trust, the surviving spouse continues as trustee and has immediate access to the trust assets. She is not compelled to immediately meet with the lawyer and go through the aggravation of filing succession papers with the court. This can provide enormous psychological relief for the survivor.

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Establishing a living trust and transferring assets to it require organizing your affairs, something that is much better done by you while alive rather than by your heirs after your death. This organizational factor in itself can save significant fees, as a well organized estate requires far less attorney and accountant time than one in which no one has a handle on the records and assets.

Another significant advantage of a living trust is that it survives the interdiction of the principal (the principal would be you, the person signing the power of attorney in favor of the agent, the person you name to represent you). Interdiction is the Louisiana term for a curatorship, guardianship or competency proceeding. Although a power of attorney survives the incompetence of the principal, it is automatically terminated if a petition is filed to interdict the principal. After an interdiction, the court will supervise the management of the person's property. An interdiction proceeding is a time consuming, complex, and expensive process. But why would an interdiction be necessary if a durable power of attorney is in place? At least two possibilities exist. First, it may be necessary to deprive the principal of his or her legal right to handle his or her own affairs. This happens in cases where the person refuses to take medication, or refuses essential medical care, or becomes physically aggressive and a danger to others. A power of attorney is not useful in such circumstances because it can be cancelled by the principal and because by signing a power of attorney the principal does not give up any rights,

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he or she just agrees to share certain powers with the agent.

A second reason that an interdiction may occur is that someone other than the agent (such as one of the principal's other children) may be displeased with the arrangement. Such a person may upset the arrangement established by the power of attorney by filing an interdiction petition asking the court to appoint him or her as curator. This places that person in charge of the principal's assets, at least temporarily, and the agent finds himself in the middle of an expensive lawsuit.

The living trust becomes irrevocable upon incapacity (for so long as the incapacity lasts). Therefore, the settlor, if incompetent, cannot revoke the trust, and neither can the agent or a curator. If an interdiction petition is filed, the curator will take control of the principal's person, controlling medical treatment and personal care decisions, but the principal's property will stay in the living trust and be controlled by the trustee. It will not become subject to the cumbersome and expensive interdiction proceeding.

6. Medicaid disadvantage. Medicaid planning is too complex for treatment here, but a living trust can prove to be a disaster if the surviving spouse needs nursing home care. The living trust could disqualify the spouse from Medicaid assistance for up to five years. A trust in a will does not have this disadvantage.

Other than the initial cost and the Medicaid trap, there is no significant disadvantage to a living trust, and it is recommended for

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many clients. However, the Medicaid trap must not be overlooked, even if you have no health problems, because over 50% of us will one day need nursing home care.

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SPECIAL USES FOR LIFE INSURANCE

Life insurance has a multitude of uses in estate planning. A few of these are discussed below.

A. *Creating an estate*. Most people will die leaving little if any estate. Life insurance is the only way such people can create an estate for their heirs to assure their comfort and well being.

B. *Protection against creditors*. An extremely valuable attribute of life insurance is that it protects the beneficiaries from creditors in most circumstances. Louisiana Revised Statute 22:647A protects the proceeds and avails of a policy, including the cash surrender value, from the beneficiary's creditors as of the time the policy proceeds become available to the beneficiary. This applies even if the beneficiary is the insured's estate or if the beneficiary is the insured's surviving spouse. (Income earned on the proceeds can be seized, though.) Note, however, that if the policy proceeds are left directly to the beneficiary, this protection does not extend to debts incurred by the beneficiary <u>after</u> the policy proceeds become available. The protection can be extended to new creditors by leaving the policy proceeds to a trust set up for the policy beneficiary. Thus:

a. If you are deeply in debt, buy a policy and name your spouse as beneficiary. If you die, your spouse will not lose the proceeds to your creditors, even as to community debts.

b. If you have a child who is constantly in debt or fiscally

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irresponsible, leave him nothing in your will, but name a trust for his benefit as beneficiary of a policy on your life. This satisfies the forced portion (assuming the proceeds at least equal his forced portion) and protects the assets of your estate for your other heirs. (Creditors can accept a succession on behalf of an heir if he does not do so himself or attempts to disclaim his inheritance. However, if he is not named in the will, the creditors have nothing to accept on his behalf.)

c. As mentioned above, if the policy proceeds are left to the child directly, they will only be protected from the child's creditors as of the time the proceeds become available to the child. Leaving the proceeds to the child in trust will extend the protection to the child's creditors who appear after the policy pays.

d. Annuities are also exempt, without limit as to the amount, but only for debts which exist when the proceeds of the annuity become available to the beneficiary. Annuities do not protect against after-acquired debt.

C. *More protection against creditors*. The cash surrender value of a policy is exempt from the owner's creditors under R. S. 22:647 D, which provides that no one can be compelled to exercise any rights, powers, options or privileges under an annuity or life insurance policy. In other words, the owner cannot be forced to exercise his option of withdrawing or borrowing on the cash surrender value.

However, if you purchase a policy within four years prior to the date you file a bankruptcy petition or the date the policy is seized pursuant to court order, a court may find you have made a "fraudulent conveyance" and allow the policy to be seized by your

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creditors.

D. *Protection in bankruptcy.* A person who files a bankruptcy petition in Louisiana is entitled to all the exemptions from seizure provided by Louisiana law, including the exemptions relating to life insurance policies and annuities. Therefore, even if a person is forced into bankruptcy, he will not be forced, as a general rule, into cashing in his policies or paying his creditors with proceeds of which he was the beneficiary on someone else's life. (WARNING: the conversion of cash and other nonexempt assets to "exempt" assets in anticipation of bankruptcy can be hazardous. Seek the advice of a knowledgeable attorney experienced in such planning if you need to consider this tactic. Furthermore, such planning must take place well in advance of the bankruptcy filing, at least four years, so get competent legal help as soon as possible.)

E. *IRS is an exception*. The exemptions from seizure provided by the Internal Revenue Code are very limited and override all other exemption statutes. Consequently, a bankruptcy proceeding provides only limited and temporary protection of exempt assets from IRS. However, even IRS cannot penetrate a properly drafted trust.

F. *Satisfy the forced portion*. Life insurance proceeds are not included in your Louisiana estate for probate or inheritance tax purposes (unless your estate is the beneficiary). Even though they do not increase your estate, the proceeds can be applied to a child's forced portion. And these proceeds can be paid into a trust with your spouse as income beneficiary for life and the child receiving no income at all until your spouse dies. Even after the death of your

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spouse, you can prevent your child from receiving the proceeds, limiting him to the income only, until his death. You cannot prevent him from leaving the principal of the trust to someone in his will, and if he dies without a will his children must inherit the principal, but if he dies intestate and without children, you can direct in the trust instrument who is then to receive the principal.

G. *Satisfy the marital portion*. Life insurance can satisfy the marital portion (La. Civil Code Art. 2435). Furthermore, the marital portion can be put in trust. If you have a large amount of separate property compared to your spouse's separate property and share of the community property, you may be a candidate for a life insurance policy to fund a trust to satisfy the marital portion. Your spouse would be the income beneficiary for life, and upon your spouse's death the principal would go to your children or remain in trust for their benefit.

H. *Disinheriting children*. Life insurance is not included in calculating the forced portion of a person's descendants. That is, it is not subject to the claims of forced heirs. If you want to disinherit one or more of your children, you can accomplish this in part by putting most of your worth into life insurance. The beneficiary cannot be forced to share the proceeds with the children.

I. *Equalizing an unequal distribution of your probate estate*. In many cases, particularly where a family business is involved, a person may want to leave most or all of his estate to one child. This unequal distribution of the estate can be equalized by naming the other children as beneficiaries of a life insurance policy, either directly or in trust.

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J. *Providing liquidity to pay death transfer costs*. Many people who die with taxable estates possess insufficient liquid assets to pay taxes, attorney fees, and other costs occasioned by the administration and settling of an estate. The assets of the estate must often be sold at reduced prices at inopportune times just to provide the necessary cash. Life insurance can provide a ready source of cash to pay these expenses. The proceeds will be taxable if the deceased had any incident of ownership of the policy, so the policy could result in additional estate tax.

Several methods can prevent this inclusion in the taxable estate. One method is to name the spouse as beneficiary so the proceeds will escape taxation by virtue of the unlimited marital deduction. However, this only delays the imposition of the tax because the proceeds will be included in the spouse's estate upon her death to the extent they haven't been spent or given away.

An attractive alternative is the use of a life insurance trust, an extremely important estate planning device for the wealthy (often very useful for the rest of us, too). The trustee, not the insured, applies for and purchases the policy. The surviving spouse is the income beneficiary of the trust for life, and the kids the principal beneficiaries and successor income beneficiaries. When the surviving spouse also dies, her income interest terminates, and she has nothing to include in her taxable estate with respect to the proceeds.

K. *Funding buy-sell agreements*. If you have a business partner, you and your partner may need a buy-sell agreement obligating the estate of the first to die to sell his share of the business to the survivor, and obligating the survivor to buy. A major concern in such an

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agreement is enforcing it if the surviving partner simply doesn't have the cash or financial wherewithal to live up to his obligation to purchase. The obvious resolution is to fund the agreement with insurance on the lives of both partners sufficient to provide the necessary proceeds. Preparing buy-sell agreements can be quite complicated and requires the involvement of a knowledgeable attorney.

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BASIC TAX CONSIDERATIONS IN ESTATE TAXATION

I. *Federal estate tax*.

A. A tax on the transfer of the decedent's property. If the property becomes valueless or ceased to exist at the decedent’s death, it is not taxed.

B. Very broad definition of property, includes proceeds from any life insurance policy over which the decedent held any incident of ownership.

C. Nontaxable amount or exemption for each person is $5,450,000.

D. Maximum estate tax rate is 40%.

E. Unlimited marital deduction. The marital deduction overrides the unified credit, which can result in a loss of the unified credit for the first spouse to die if the will is not drafted properly and if “portability” is not applicable. Although under current law the surviving spouse can benefit from the unused the exemption of the deceased spouse, that benefit can be lost, such as if the surviving spouse remarries.

II. *Federal generation skipping tax*.

A. Designed to tax transfers that attempt to avoid tax at the second generation by sending property directly to a generation below the

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second. (Usually, a grandparent donating directly to grandchildren.)

B. Taxed at maximum federal estate tax rate.

C. Exemption or nontaxable amount. Like the unified credit, the nontaxable amount for generation skipping tax purposes is $5,450,000.

D. Annual exclusion of $14,000 per year, same as for gifts, but special requirements apply.

III. *Gift tax*.

A. Lifetime gifts are taxed at same rate as estates, with a lifetime exemption or tax free amount of $5,450,000 per donor. In short, the government will tax your estate if you give it away while you are alive as well as if you give it away at your death.

B. $14,000 per year annual exclusion for each donor as to each donee. For example, a husband and wife can give a total of $28,000 to each of their children and grandchildren and not have to pay any gift tax or file a gift tax return. Any excess above that amount will be offset by the $5,450,000 exemption, but a gift tax return must nevertheless be filed in order to show the offset. If the taxable gifts exceed $5,450,000 during a person's lifetime, the excess is taxable.

IV. *Louisiana inheritance and gift tax*.

Louisiana no longer has inheritance or gift taxes.

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Appendix A

Forced Heirship

A. *Applies only if you have a will*. Forced heirship is not a concern if you die without a will, as you are not forced to die intestate. If you die without a will, everything goes to your children (see below for details), not just the forced portion. Forced heirship applies only if you write a will that attempts to leave your forced heirs less than the minimum the law says you must.

B. *Not only in Louisiana*. Louisiana is unique in the United States in that it does not allow you to disinherit your children under age 24, who are disabled at the date of your death, or who have an inherited disease that could result in disability. However, most other states allow you to disinherit your children but do not allow you to disinherit your spouse. Although this is not referred to as forced heirship, but rather the "elective share" or similar terms, it is in fact forced. In a sense, all community property states provide some degree of forced heirship by classifying most assets acquired during the marriage as community assets, thereby giving ownership of one-half of the assets acquired by each spouse to the other.

C. *Forced heirs*.

1. The Louisiana Civil Code defines forced heirs as children of the decedent under the age of 24 who are not permanently disabled, as well as grandchildren in some circumstances:

    Art. 1493. Forced heirs; representation of forced heirs

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A. Forced heirs are descendants of the first degree who, at the time of the death of the decedent, are twenty-three years of age or younger or descendants of the first degree of any age who, because of mental incapacity or physical infirmity, are permanently incapable of taking care of their persons or administering their estates at the time of the death of the decedent.

B. When a descendant of the first degree predeceases the decedent, representation takes place for purposes of forced heirship only if the descendant of the first degree would have been twenty-three years of age or younger at the time of the decedent's death.

C. However, when a descendant of the first degree predeceases the decedent, representation takes place in favor of any child of the descendant of the first degree, if the child of the descendant of the first degree, because of mental incapacity or physical infirmity, is permanently incapable of taking care of his or her person or administering his or her estate at the time of the decedent's death, regardless of the age of the descendant of the first degree at the time of the decedent's death.

D. For purposes of this Article, a person is twenty-three years of age or younger until he attains the age of twenty-four years.

E. For purposes of this Article "permanently incapable of taking care of their persons or administering their estates at the time of the death of the decedent" shall include descendants who, at the time of death of the decedent, have, according to

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medical documentation, an inherited, incurable disease or condition that may render them incapable of caring for their persons or administering their estates in the future.

2. The law seems harsh on grandchildren of a predeceased child -- few grandchildren will qualify, even though very young, because the grandchild will be a forced heir only if his deceased parent (your child) would have been less than the age of 24 at the date of your death, or if the grandchild is disabled and his parent (your child) has predeceased you.

D. *Exception* -- a person can disinherit a forced heir for "just cause," which is defined by the Civil Code as follows:

Art. 1621. Children; causes for disinherison by parents

A. A parent has just cause to disinherit a child if:

(1) The child has raised his hand to strike a parent, or has actually struck a parent; but a mere threat is not sufficient.

(2) The child has been guilty, towards a parent, of cruel treatment, crime, or grievous injury.

(3) The child has attempted to take the life of a parent.

(4) The child, without any reasonable basis, has accused a parent of committing a crime for which the law provides that the punishment could be life imprisonment or death.

(5) The child has used any act of violence or coercion to hinder a parent from making a testament.

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(6) The child, being a minor, has married without the consent of the parent.

(7) The child has been convicted of a crime for which the law provides that the punishment could be life imprisonment or death.

(8) The child, after attaining the age of majority and knowing how to contact the parent, has failed to communicate with the parent without just cause for a period of two years, unless the child was on active duty in any of the military forces of the United States at the time.

B. For a disinherison to be valid, the cause must have occurred prior to the execution of the instrument that disinherits the heir.

E. *Forced portion*. The forced portion is the minimum amount that you must leave to your forced heirs, no matter what you say in your will. The amount that a particular heir may inherit is referred to as his forced portion, or more precisely, as his legitime (pronounced "lej'-i-teem").

One forced heir -- ¼ of your estate (actually, ¼ of the "active mass.")

Two or more forced heirs -- ½ of your estate, shared equally.

For example, if you have three forced heirs, the forced portion would be one-half of your active mass, or one-sixth for each child.

The active mass is computed by adding to the probate estate most gifts made by the decedent while alive. For gifts made after January

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1, 1996, only those gifts made within three years of the date of the decedent's death are included. In some situations, therefore, the active mass may be much larger than the so-called "probate" estate.

F. *Disposable portion*. The remainder of your estate is the disposable portion, which you can leave to whomever you please.

G. *By roots*. Forced heirship is "by roots" or "per stirpes." If one of your children predeceases you, his children split your deceased child's share rather than each getting a full share. (But remember, his children will be forced heirs only if the predeceased child would not have reached the age of 24 at the date of your death or if that grandchild is unable to take care of himself because of physical or mental problems.)

H. *Option of child*. You can write your will to disinherit your children, and they may consent to this disinherison after your death. Nothing requires them to exercise their rights of forced heirship, and a creditor cannot force them to claim the forced portion if left out of your will. (If the child files bankruptcy, the trustee will stand in his shoes and may bring an action to recover the forced portion if the time to do so has not then expired.) Of course, any forced heir who is a minor must have his or her tutor (the Louisiana term for guardian) disclaim the forced portion, which requires court approval and a very good reason.

However, usually it is not a good idea for forced heirs to renounce. Why? Because stacking the forced portion in the surviving spouse's estate may subject it to his or her creditors or require it to be spent before the surviving spouse can qualify for Medicaid payment of nursing home care. Additionally, the surviving spouse may one day

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write a will to leave the child's share to someone other than child.

GETTING AROUND FORCED HEIRSHIP

There are several ways you can avoid or mitigate the effects of forced heirship. Some of these involve the use of a will or a "will substitute," such as a trust. The great majority of clients find they have no problem with forced heirship, so long as the surviving spouse is protected, and don't really want to overcome forced heirship, but only delay its effects. However, in those rare instances where a person may be motivated to reduce the effects of forced heirship, the following tactics are helpful.

A. Buy life insurance or invest in a qualified retirement plan (including an IRA).

1. Any amounts paid into a life insurance policy or qualified retirement plan, and the proceeds from the policy or plan, are exempt from forced heirship. What's more, if your child is the beneficiary of these proceeds, the proceeds automatically apply against that child's forced portion. Regular or nonqualified annuities are not protected from forced heirs, only those that qualify as retirement plans under the Internal Revenue Code. (Incidentally, nonqualified annuities are also subject to Louisiana inheritance tax.)

2. Life insurance or retirement plans can be an important estate planning device if you have a particular asset that you want to leave to one child alone. E.g., if you want to leave the family business to child A, but not to child B, you can do so if child B receives his forced portion from other assets, which may require life insurance or retirement plan proceeds.

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3. Life insurance and retirement plan proceeds do not increase the forced portion.

4. Caution. The life insurance proceeds are a part of your federal taxable estate if you possess any incident or power of ownership of the policy or plan. Retirement plan proceeds are also subject to federal estate tax.

5. Incidentally, life insurance and retirement plan proceeds are exempt from your creditors, even as to community debts. So any such proceeds your spouse or other beneficiary receives cannot be seized by creditors after your death. (Planning to avoid creditors is a complicated area of the law that should not be undertaken without the advice of an attorney with experience in this area.)

B. Burden the forced portion with a usufruct in favor of your spouse. Your forced heirs will own the property, but your surviving spouse will have the right to the income from the property and the right to use it.

C. Leave the forced portion in trust (a "legitime trust") created either in your will or by a living trust.

1. You can require in the trust instrument that the forced heir receive only income, not principal. A trust is the only way to keep the assets of the forced portion out of a child's hands beyond the life of your surviving spouse.

2. Although you can keep the principal out of your child's hands for his lifetime, you cannot prevent him from directing the

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disposition of his forced portion in his will (presuming he is at least 16 years old and mentally competent to write a will).

3. If your child dies both intestate and without descendants, you can specify the successor principal beneficiary of the forced portion.

4. You can designate your spouse as income beneficiary for life, but your forced heir must be the successor income beneficiary.

5. Alternatively, if you are not married, or you do not want your spouse to be the income beneficiary, you can place low income producing assets in the trust (but you cannot use non-income producing assets).

D. Leave the forced portion into a grandchildren's trust for the forced heir's children, and provide in your will that if the forced heir demands his forced share, his portion will come out of the grandchildren's trust and go into a trust for life for the forced heir, out of which he will receive only income.

E. You and your spouse can place certain property into a partnership or limited liability company (LLC). You then specify in your will that the forced portion will be satisfied by the interest in the partnership or LLC. Your forced heir therefore doesn't receive an interest in the property itself, just an interest in a partnership or LLC, thereby preventing him or a trustee from directly owning or controlling the property.

F. *Warning*. Real estate you own in another state is no longer exempt

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from forced heirship if at the date of your death you are domiciled in Louisiana and have at least one forced heir who at the time is domiciled in Louisiana. (La. Civ. Code art. 3534.) Until recently, real estate located outside of Louisiana was not subject to forced heirship. (On the other hand, now foreigners and out-of-staters can buy Louisiana real estate and not be bound by our laws of forced heirship.)

G. Give away all of your assets and live for at least three years. Donations made more than three years before death are not counted in computing the forced portion.

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