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Estate Planning
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Estate planning options for blended families

The dynamics of a blended family, defined as one where at least one spouse has at least one child from a prior marriage or relationship, can complicate financial and estate planning because no off-the-shelf plans apply.

It's important to contact your estate-planning lawyer to ensure complete review of all personal and economic aspects of your family and a resulting plan that works for everyone involved.

From designating account beneficiaries to updating wills and trusts, it takes attention to detail to ensure specific wishes are carried out properly. Effective, collaborative planning can address the family's needs and goals while building trust and helping everyone move forward together.

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A good place to start is with reviewing and updating beneficiary designations for life-insurance policies and retirement accounts. That's a simple way to ensure that the proper beneficiaries are noted on all accounts and the proceeds from those accounts end up going to the correct individuals.

While any estate planning must be done on a case-by-case basis, the following are options to consider for blended families:

Reciprocal wills

Some blended families use reciprocal wills, where the assets pass outright to the surviving spouse, as their primary estate plan. They do this for the sake of simplicity and to keep their estate planning costs at a minimum. But this type of plan comes with some serious disadvantages. One issue is that it does not provide a great deal of comfort when there are children from a prior marriage, because the first spouse to die has no guarantee that the surviving spouse will provide for his or her children when the surviving spouse ultimately dies. There are several ways the surviving spouse can defeat the intent of the deceased spouse even without changing his or her will, including making gifts of assets during his or her lifetime, changing beneficiary designations, and retitling assets as joint with a right of survivorship with his or her own children or even a new spouse, potentially leaving nothing to pass under his or her reciprocal will.
Another major disadvantage of a reciprocal will is that it is revocable. That means the surviving spouse can change it to favor his or her own

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Beware the pitfalls of naming a minor as your beneficiary

A minor generally doesn't have the right to manage his or her assets, including any inheritance.

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But sometimes a minor child becomes the beneficiary of a sizable family inheritance. That can occur because a parent dies without a will or trust, leading to an unavoidable direct inheritance by the child.

If a minor is chosen as a beneficiary of a retirement account or life insurance policy, many challenging issues can arise.

First of all, a minor is not legally allowed to take control of inherited assets left directly to him or her. Instead, an adult or financial institution has to be appointed to manage the estate until the minor turns 18.

In essence, that means the estate must be overseen by the probate court, a time-intensive and costly endeavor, which also requires an attorney to file annual accountings for the guardian or conservator. The court then evaluates all expenses and investments to be sure the assets are managed properly.

Most spending from the minor's assets must be authorized by the court. It's challenging to get such approval, too, because the court typically aims to protect the minor's assets until he or she reaches age 18.

Meanwhile, any fees to administer the estate also reduce the value of the minor's inheritance over time, as that is the source from which the fees are typically paid.

Finally, at age 18 all estate assets will be distributed directly to the minor, a result that many families may not like.

How to change an irrevocable trust

When dealing with irrevocable trusts the ability to effect change can be difficult to understand, presenting more questions than answers.

The correct answers often depend on a variety of factors, but a good starting point is state law and the trust document itself.

When modification or termination of an irrevocable trust is sought, a possible mechanism is for the trustee or beneficiary to seek a court order.

When it comes to interpreting language in an irrevocable trust, appointing a trustee or providing directives to a trustee, a non-judicial settlement agreement may be an alternative to filing a court proceeding.

In some states, trustees, heirs, spouses and beneficiaries are among those permitted to enter into a binding non-judicial settlement agreement, so long as the terms do not violate a material purpose of the trust, the terms and conditions could otherwise be properly approved by the court, and any modifications sought are not already provided for in the trust.

Even if the trust is irrevocable, it may still be possible to carry out a change in who receives estate assets upon the death of the trust creator through exercising a power of appointment. A power of appointment is created when one person grants another the authority to dispose of property by designating a recipient of that property.

It is not unusual for the creator of a trust to have assigned the surviving spouse or trustee a power of appointment. If this power was granted, and the requested modifications of the trust involve disposing of property or changing a designated beneficiary, exercising a power of appointment could be a means to that end.

Some states also allow trust "decanting" as another means for modifying irrevocable trusts. A trust decanting involves a trustee's exercise of discretion to distribute trust assets to another trust with dissimilar terms. The ability to decant irrevocable trusts depends on state law and varies from state to state.

For help with concerns involving irrevocable trusts, you should meet with an estate planning attorney to assist you with analyzing your trust instrument and to discuss the modifications being contemplated, the applicable law and the best course of action.

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children, charities or a new spouse. The surviving spouse also could deplete the estate by overspending and incurring debt, leaving nothing for the children of the deceased spouse.

Non-reciprocal wills

An option that does not require reliance on and trust in the surviving spouse is to have each spouse create a non-reciprocal will, or wills that are not exactly the same and don't leave the estate outright to the surviving spouse. Under this approach, each spouse could leave a percentage or dollar amount to the surviving spouse and a percentage or dollar amount to be divided equally between his or her own children, but not the children of the other spouse. It can be difficult to determine at the time the will is made the amount needed to provide for the spouse and an appropriate amount to go to the children, so this type of estate plan likely requires monitoring and updating over time.

Life insurance

A third alternative is to purchase life insurance to provide for the surviving spouse or the children of the first spouse to die. The advantage with using life insurance is that it guarantees, as long as the policy is active, that the children will receive something upon the death of their parent. Life insurance policies tend to become increasingly expensive as you grow older, however.

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Life insurance provided by an employer can be used, but there are limits to the amount an employer provides. Also, coverage usually terminates when employment ends and may become unavailable if an employer files for bankruptcy. Therefore, relying solely upon employer-provided life insurance may not be the best alternative.

Testamentary trusts

Creating a testamentary trust that becomes irrevocable upon the death of the first spouse meets the dual goals of providing for the surviving spouse during his or her remaining lifetime and then, upon the death of the surviving spouse, passing the remaining assets to the children of the first spouse to die.

Under this approach, a trustee will have to be appointed. Common options include the surviving spouse, a child of the first spouse to die, a third party or a trust company. Appointing the surviving spouse or a child of the deceased spouse has a greater risk of creating family friction, and therefore a third party or a trust company might be more appropriate.

Whichever option you chose, any estate plan should remain dynamic and adapt to change when necessary, particularly given the added complexities of a blended family.

Review your estate plan when you move across state lines

When you make a move out of state, be sure to review your estate plan with an estate planning attorney in your new domicile, as trust and estate laws have some differences from state to state.

In most states, the probate court will recognize a will from another state. But in the case of a dispute, you can't be sure the judge in the new state will understand your will the way that you meant it.

Your new place of residence might place restrictions on executors from out of state. It's also possible that your new medical provider or bank won't adhere to powers of attorney drafted under another state's laws.

One big issue is whether you're moving from a common-law property state — which is the case in most states — to a community property state, or vice versa. In a common-law state each spouse's separate property obtained during marriage remains separate, while in a community property state assets acquired during a marriage are jointly held by both spouses. When you move between states with different governing principles on this issue, it can become unclear who owns what property at death, and measurable estate tax consequences might arise.

Income tax rules also differ from state to state. Some states don't have an income tax, while others have significant income tax rates, which would have an impact on your estate plan. In some states, the law might allow a lower exclusion than the federal estate tax. If you don't pay attention, you could have your estate taxed by your new state even if your estate is under the federal exclusion amount.

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Issues to consider before gifting your home to your child

Passing your house on to your children before your death offers some advantages, but there are pitfalls to avoid.

If your children inherit the property through your estate, the cost basis on the property will be the value of the home on the day of your death. But if you gift the children the property while you are still alive, they will inherit your cost basis, including potentially large capital gains if they decide to later sell the home.

You still might want to remove the property from your estate to help you better qualify for assistance with long-term-care costs. But be aware that you are subject to a five-year look-back on assets. That means that when you apply for Medicaid, gifts or transfers of assets you make within five years of the date of the application for assistance may be subject to inclusion in your estate.

If you want to keep living on the property but for estate-planning purposes hand ownership over to your children, consider that your child will technically be your landlord. To avoid disagreements, make it clear up front who will be responsible for utilities, maintenance and any associated costs, and any desired renovations or updates along the way. It's best for you to put these intentions in writing from the start.

Parents who want to stay in the house but no longer include any appreciated value on the home in their estate might want to consider a qualified personal residence trust, or QPRT. This instrument allows the gifting process to begin while you retain control of the house and still live in it. Typically you would retain the right to live in the house rent-free for a specified period of years (10 is common), after which point the remainder beneficiaries of the trust become fully vested in their interest in the primary residence.

Be aware that an existing mortgage on the property can be problematic. Some mortgage lenders will call in their loans when the property are transferred to others, meaning your child could have to take out a mortgage with an interest rate and other costs that are higher than what you've been paying. If your child is allowed to assume your mortgage, he or she needs to be clear on all terms and future costs.