If you have minor children, you must read this before you set up your Will…

Will a Stranger get Money from Your Life Insurance?

Just who do you think will benefit from your life insurance proceeds? You say, that's a good question with a very simple answer. "I named my spouse as beneficiary and my kids as the contingent beneficiaries and they will get the proceeds!" Since insurance is purchased because problems can occur, let's examine some possible problems if this is your answer.

Consider first, the hypothetical "Smith Family." Joe and Susan Smith have two children, Jim and Sally. The Smith's have purchased two life insurance policies, a $200,000 policy on Jim and a $100,000 policy on Susan. Both policies name the other spouse as beneficiary with the kids as contingent beneficiaries. The Smiths have been thinking for some time about getting wills and have even talked to their good friends, Bob and Mary Franklin, about caring for their children if anything ever happened to them. <u>But they have not gotten around to taking care of it!</u>

Unfortunately, Joe is killed in an accident at work. The insurance company pays the $200,000 to Susan. Susan has never had that much money in her life. A year later, Susan realizes she has already gone through $80,000 of the $200,000 insurance proceeds.

A few months later, Susan marries Sam Anderson. Sam has just started a new business that is short of working capital and you can guess the solution to the problem. That's right, they take $50,000 from Susan's account for the business and while the business is getting on its feet, Susan pays their rent from income in her account. (Susan really does not want to take the money out of her account, but Sam pressures her and she cannot say no). Everything is proceeding just fine, except Sam's business is losing money, and the kids are having a tough time adjusting to Sam.

Then Susan has an auto accident and dies. Susan had not changed her insurance policy so $100,000 is due to be paid to the beneficiaries, Jim and Sally, who are now eight and ten years old. Susan's brother, Frank, who has a drinking problem, quickly files a court action to be named guardian and conservator for Jim and Sally <u>and their assets</u>. (Asking the estate to pay the legal fees). Since Sam had promised Susan he would care for her children if anything happened to her, Sam files a similar legal motion. (Also asking the estate to pay the legal fees). Bob and Mary Franklin are scared off by the battle.

Two questions are at stake, who will care for the kids and who will manage the money?

There is still $70,000 in Susan's account from Joe's original insurance policy after earning some interest and paying bills. Sam's attorney points out to Sam that since the account has been for their joint support, Sam is entitled to some support. So Sam claims $35,000 for himself.

That still leaves $35,000 from Joe's insurance plus $100,000 from Susan's insurance, the savings account, and the mutual funds for Sam and Frank to fight over. Both Sam and Frank have their attorney's, and the court appoints another attorney to look out for the rights of the kids. Since Susan still did not have a will, the probate court appoints yet another attorney to handle the probate of her estate. You get the picture! Murphy's Law has taken over!

For Your Kids' Sake, Plan Ahead with an Easy Solution to Avoid Financial Disaster!

In contrast to the above story, let's assume that Joe and Susan had implemented a set of legal documents after they purchased their life insurance. Their legal documents included Living Wills, Durable Power of Attorney's and Pour-Over Wills for both Joe and Susan. They also included in their estate plan an Affidavit of Guardianship specifying who would care for Jim and Sally if something happened to Joe and Susan, a Revocable Living Trust and letters to the bank and mutual fund companies to change ownerships into the name of the trust, and letters to the insurance companies to change the beneficiary of each policy to the trust.

Trust a Trust!

Let's make sure we understand the nature of a Revocable Living Trust. A trust is a legal entity similar in some ways to a corporation, in that it can buy or sell property as a separate "legal person" in the eyes of the law. It is created by a gift from the Grantor's and it can be added to at anytime. Since it is revocable, there are no tax consequences. Any trust income is reported on the Grantor's normal tax return. The assets in a trust are managed by parties called Trustees. The law clearly allows the Grantors to serve as Trustees, so Joe and Susan name themselves as Trustees and thus have no management fees or loss of control of the assets. The trust also names Beneficiaries (in this case their kids, Jim and Sally) and Successor Trustees in case the original Trustees become incapacitated or die. The trust also includes instructions to Successor Trustees how the trust assets should be managed and used to care for (or be distributed to) the beneficiaries.

No Probate! Since the property in a Trust is not technically owned by the Grantors, if a Grantor dies there is no need for probate. (The "pour-over-will" is a back-up in case the Grantor failed to put all assets in the trust and names the trust as heir to the estate. It "pours" the assets into the trust and the trust makes distributions according to the instructions left by the Grantors). The Durable Power of Attorney's give the designated person(s) power to act on their behalf if either Joe or Susan becomes incapacitated. The Living Wills give instructions to medical personnel if either Joe or Susan end up being kept alive artificially.

No Problems! Joe and Susan specified in their trust if, Joe dies first, his brother Pete would become a co-trustee with Susan and if Susan dies first, her father would serve as co-trustee with Joe. It further specified that if Joe dies, $50,000 of the proceeds from his insurance will be invested in a separate account that can only be used for their kid's educations with any remaining assets from this account to be distributed to them when the youngest child reaches age twenty-five.

Now if we went through the same set of circumstances, the outcome would be entirely different. Susan would not have spent $80,000 of Joe's $200,000 insurance proceeds in the first year after his death, because Joe's brother as co-trustee would have helped her control the spending. When Sam asked for the $50,000 for his business, Susan would have told him, "The co-trustee won't let me do it!" Sam would not have gotten $35,000 when Susan died, because co-mingling would not have taken place since the insurance proceeds from Joe's policy would have remained in the trust. (If Susan and Sam had divorced the funds in the trust would not have been subject to division by a divorce court).

There would be no battle for custody because the Affidavit of Guardianship would prevail and no probate because Susan's assets would still be in the trust. The Successor Trustees originally designated by Joe and Susan would maintain the assets and use them for the benefit of Jim and Sally and the money would be there for Jim's and Sally's educations.

Yes, it is important that you provide for your loved ones in case you die! But, it is equally important that you make sure the proper set of legal instruments are executed so the assets you hoped would go to care for your loved ones are not mismanaged, used to pay unnecessary legal expenses, split with a future spouse in a divorce settlement or wiped out by any of the other problems that can occur when the proper planning is absent.

The Revocable Living Trust and the other instruments described above have become widely known as necessities for elderly people who are concerned about possible incapacitation, avoidance of probate, and minimization of estate taxes. But, a death in a family with minor children can create even greater problems. When a tragedy strikes, it's too late to prepare. Now is the time to get things in order so your family will be protected.