Financial Focus

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Will vs. Trust: Is One Better Than the Other?

When it comes to planning your estate, you might be wondering whether you should use a will or a trust (or both). Understanding the similarities and the differences between these two important documents may help you decide which strategy is better for you.

What is a will?

A will is a legal document that lets you direct how your property will be dispersed (among other things) when you die. It becomes effective only after your death. It also allows you to name an estate executor as the legal representative who will carry out your wishes.

In many states, your will is the only legal way you can name a guardian for your minor children. Without a will, your property will be distributed according to the intestacy laws of your state. Keep in mind that wills and trusts are legal documents generally governed by state law, which may differ from one state to the next.

What is a trust?

A trust document establishes a legal relationship in which you, the grantor or trustor, set up the trust, which holds property managed by a trustee for the benefit of another, the beneficiary. A revocable living trust is the type of trust most often used as part of a basic estate plan. "Revocable" means that you can make changes to the trust or even end (revoke) it at any time. For example, you may want to remove certain property from the trust or change the beneficiaries. Or you may decide not to use the trust anymore because it no longer meets your needs.

A living trust is created while you're living and takes effect immediately. You may transfer title or "ownership" of assets, such as a house, boat, automobile, jewelry, or investments, to the trust. You can add assets to the trust and remove assets thereafter.

How do they compare?

While both a will and a revocable living trust enable you to direct the distribution of your assets and property to your beneficiaries at your death, there are several differences between these documents. Here are a few important ones.

- A will generally requires probate, which is a public process that may be time-consuming and expensive. A trust may avoid the probate process.
- In order to exclude assets from probate, you must transfer them to your revocable trust while you're living, which may be a costly, complicated, and tedious process.
- Unlike a will, a trust may be used to manage your financial affairs if you become incapacitated.
- If you own real estate or hold property in more than one state, your will would have to be filed for probate in each state where you own property or assets. Generally, this is not necessary with a revocable living trust.
- A trust can be used to manage and administer assets you leave to minor children or dependents after your death.
- In a will, you can name a guardian for minor children or dependents, which you cannot do with a trust.

Which is appropriate for you?

The decision isn't necessarily an "either/or" situation. Even if you decide to use a living trust, you should also create a will to name an executor, name guardians for minor children, and provide for the distribution of any property that doesn't end up in your trust. There are costs and expenses associated with the creation and ongoing maintenance of these legal instruments.

Whether you incorporate a trust as part of your estate plan depends on a number of factors. Does your state offer an informal probate, which may be an expedited, less expensive process available for smaller estates? Generally, if you want your estate to pass privately, with little delay or oversight from a probate court, including a revocable living trust as part of your estate plan may be the answer.

Don't Forget to Include Memory Loss When Planning for Retirement

When planning for retirement, an important factor that is often overlooked is the potential for declining cognitive skills associated with aging. Cognitive impairment (CI), often attributable to dementia or Alzheimer's disease, can have profound implications for your overall health and well-being, particularly during retirement. The cost of care can absorb income and significantly deplete retirement savings. It can also deprive you of the ability to effectively manage your financial affairs.

Cognitive impairment — a growing concern

The possibility of suffering from some form of cognitive impairment later in life is real. Dementia affects approximately 2.4 to 5.5 million Americans. Its prevalence increases with age: 5% in persons ages 71 to 79, 24% in those ages 80 to 89, and 37% in those 90 and older.[1] One in eight adults age 60 and older (12.7%) experiences confusion or memory loss that is happening more often or getting worse. Unfortunately, among these individuals, only 19.3% discuss these changes with a health-care provider. Additionally, 34.5% of those affected by CI live alone.[2]

Financial impact of the cost of care

Dementia, including Alzheimer's, is the most costly disease in the United States and is set to increase like no other. In 2016, Alzheimer's and other forms of dementia will cost the United States an estimated $236 billion. By 2050, this number is expected to grow to more than $1.2 trillion. Among all nursing home residents, more than 64% have been diagnosed with Alzheimer's or another dementia. Alzheimer's is the sixth highest cause of death in the United States.[3]

Unfortunately, those suffering from advanced stages of cognitive impairment often require long-term care. The cost of care can quickly deplete your retirement savings and affect the quality of life for you and your family, leaving little or no income or savings. Average costs of long-term care include the following:[4]

- $6,235 per month, or $74,820 per year, for a semi-private room in a nursing home
- $6,965 per month, or $83,580 per year, for a private room in a nursing home
- $3,293 per month for a one-bedroom unit in an assisted living facility
- $21 per hour for a home health aide
- $19 per hour for homemaker services
- $67 per day, or roughly $2,010 per month, for services in an adult day health-care center

The cost of long-term care depends on the type and duration of care you need, the health-care provider you use, and where you live. While one-third of 65-year-olds may never need long-term care, 20% will need it for more than five years.[5]

Loss of ability to manage finances

Your financial plan should consider not only the potential cost of care if you or your spouse suffer from cognitive impairment, but also determine who will make financial decisions about your care.

Even if you suffer from mild cognitive impairment (MCI), you may find it more difficult to manage investments or a household budget. If you are the primary money manager and experience declining cognitive skills, your spouse could be left financially vulnerable.

Make it part of your plan

A comprehensive financial and legal plan is important. It is helpful to prepare as early as possible. Some families use the services of an elder law attorney.

There may come a time when you can no longer make decisions for yourself, including financial and health-care decisions. This can create a hardship for a caregiver trying to conduct financial transactions and make medical decisions. Several types of legal documents can be written before they are needed to help you and family members through this difficult time. These documents include, but are not limited to, an advance medical directive, a medical power of attorney or health-care proxy, and a durable power of attorney, which allows a representative or agent to make financial decisions and transactions on your behalf, should you become unable to do so.

There are generally three ways to pay for long-term care expenses: use your own income and savings, share the cost of care through some form of private insurance, and/or seek the assistance of state or federal government programs, such as Medicare and Medicaid. The choices you make will likely depend on several factors, including your financial and family situation, your age, and your state of residence. In any case, it's wise to consider the ramifications of cognitive impairment when planning for retirement.

1 U.S. Preventive Services Task Force, Cognitive Impairment in Older Adults: Screening, March 2014

2 The Healthy Brain Initiative: The Public Health Road Map for State and National Partnerships, 2013-2018: Chicago, IL: Alzheimer's Association; 2013

3 Alzheimer's Association, alz.org

4 U.S. Department of Health and Human Services (most recent government data available), longtermcare.gov

5 U.S. Department of Health and Human Services (most recent government data available), longtermcare.gov

A complete statement of coverage, including exclusions, exceptions, and limitations, is found only in the long-term care policy. It should be noted that carriers have the discretion to raise their rates and remove their products from the marketplace.

Grandparents Can Help Bridge the College Cost Gap

Assets in 529 plans reached $266.2 billion, spread over 12.7 million accounts, as of the second quarter of 2016.

Source: College Savings Plans Network, 529 Report: An Exclusive Mid-Year Review of 529 Plan Activity, September 2016

***Note:** Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing, along with each plan's specific investment options, underlying investments, and investment company. More information can be found in the plan's official disclosure statements and prospectus, which should be read carefully before investing. As with any investment, there are generally fees and expenses associated with participation in a 529 plan. There is also the risk that your underlying investments may lose money or not perform well enough to cover college costs as anticipated. Finally, be aware that your ability to take advantage of any 529 plan state tax benefits may be contingent on your enrollment in your own state's 529 plan.*

For many families, a college education is a significant financial burden that is increasingly hard to meet with savings, current income, and a manageable amount of loans. For some, the ace in the hole might be grandparents, whose added funds can help bridge the gap. If you're a grandparent who would like to help fund your grandchild's college education, here are some strategies.

529 college savings plan

A 529 college savings plan is one of the best vehicles for multigenerational college funding. 529 plans are offered by states and managed by financial institutions. Grandparents can open a 529 account on their own — either with their own state's plan or another state's plan — and name their grandchild as beneficiary (one grandchild per account), or they can contribute to an existing 529 account that has already been established for that grandchild (for example, by a parent).

Once a 529 account is open, grandparents can contribute as much or as little as they want, subject to the individual plan's lifetime limits, which are typically $300,000 and up. Grandparents can set up automatic monthly contributions or they can gift a larger lump sum — a scenario where 529 plans really shine.

Contributions to a 529 plan accumulate tax deferred (which means no taxes are due on any earnings made along the way), and earnings are completely tax-free at the federal level (and typically at the state level) if account funds are used to pay the beneficiary's qualified education expenses. (However, the earnings portion of any withdrawal used for a non-education purpose is subject to income tax and a 10% penalty.)

Under rules unique to 529 plans, individuals can make a lump-sum gift of up to $70,000 ($140,000 for joint gifts by a married couple) and avoid federal gift tax by making a special election on their tax return to treat the gift as if it were made in equal installments over a five-year period. After five years, another lump-sum gift can be made using the same technique. This strategy offers two advantages: The money is considered removed from the grandparents' estate (unless a grandparent were to die during the five-year period, in which case a portion of the gift would be recaptured), but grandparents still retain control over their contribution and can withdraw part or all of it for an unexpected financial need (the earnings portion of such a withdrawal would be subject to income tax and a 10% penalty, though).

What happens at college time if a grandchild gets a scholarship? Grandparents can seamlessly change the beneficiary of the 529 account to another grandchild, or they can make a penalty-free withdrawal from the account up to the amount of the scholarship (though they would still owe income tax on the earnings portion of this withdrawal).

Finally, a word about financial aid. Under current federal financial aid rules, a grandparent-owned 529 account is not counted as a parent or student asset, but *withdrawals* from a grandparent-owned 529 account are counted as student income in the following academic year, which can decrease the grandchild's eligibility for financial aid in that year by up to 50%. By contrast, parent-owned 529 accounts are counted as parent assets up front, but withdrawals are not counted as student income — a more favorable treatment.

Outright cash gifts

Another option for grandparents is to make an outright gift of cash or securities to their grandchild or his or her parent. To help reduce any potential gift tax implications, grandparents should keep their gift under the annual federal gift tax exclusion amount — $14,000 for individual gifts or $28,000 for joint gifts. Otherwise, a larger gift may be subject to federal gift tax and, for a gift made to a grandchild, federal generation-skipping transfer tax, which is a tax on gifts made to a person who is more than one generation below you.

An outright cash gift to a grandchild or a grandchild's parent will be considered an asset for financial aid purposes. Under the federal aid formula, students must contribute 20% of their assets each year toward college costs, and parents must contribute 5.6% of their assets.

Pay tuition directly to the college

For grandparents who are considering making an outright cash gift, another option is to bypass grandchildren and pay the college directly. Under federal law, tuition payments made directly to a college aren't considered taxable gifts, no matter how large the payment. This rule is beneficial considering that tuition at many private colleges is now over $40,000 per year. Only tuition qualifies for this federal gift tax exclusion; room and board aren't eligible.

Aside from the benefit of being able to make larger tax-free gifts, paying tuition directly to the college ensures that your money will be used for education purposes. However, a direct tuition payment might prompt a college to reduce any potential grant award in your grandchild's financial aid package, so make sure to ask the college about the financial aid impact of your gift.

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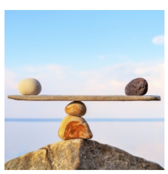

Should I pay off my student loans early or contribute to my workplace 401(k)?

For young adults with college debt, deciding whether to pay off student loans early or contribute to a 401(k) can be tough. It's a financial tug-of-war between digging out from debt today and saving for the future, both of which are very important goals. Unfortunately, this dilemma affects many people in the workplace today. According to a student debt report by The Institute for College Access and Success, nearly 70% of college grads in the class of 2014 had student debt, and their average debt was nearly $29,000. This equates to a monthly payment of $294, assuming a 4% interest rate and a standard 10-year repayment term.

Let's assume you have a $300 monthly student loan payment. You have to pay it each month--that's non-negotiable. But should you pay more toward your loans each month to pay them off faster? Or should you contribute any extra funds to your 401(k)? The answer boils down to how your money can best be put to work for you.

The first question you should ask is whether your employer offers a 401(k) match. If yes, you shouldn't leave this free money on the table. For example, let's assume your employer matches $1 for every dollar you save in your 401(k), up to 6% of your pay. If you make $50,000 a year, 6% of your pay is $3,000. So at a minimum, you should consider contributing $3,000 per year to your 401(k)--or $250 per month--to get the full $3,000 match. That's potentially a 100% return on your investment.

Even if your employer doesn't offer a 401(k) match, it can still be a good idea to contribute to your 401(k). When you make extra payments on a specific debt, you are essentially earning a return equal to the interest rate on that debt. If the interest rate on your student loans is relatively low, the potential long-term returns earned on your 401(k) may outweigh the benefits of shaving a year or two off your student loans. In addition, young adults have time on their side when saving for retirement, so the long-term growth potential of even small investment amounts can make contributing to your 401(k) a smart financial move.

All investing involves risk, including the possible loss of principal, and there can be no guarantee that any investing strategy will be successful.