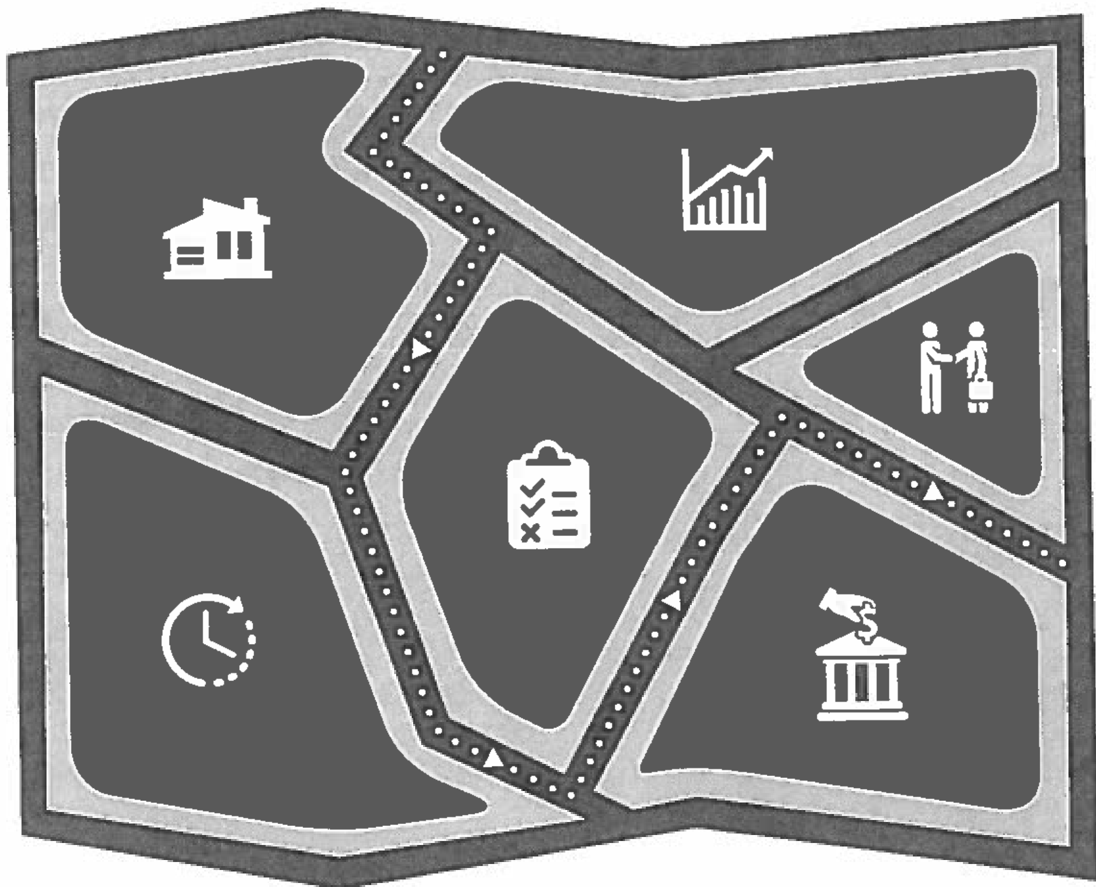
Estate Planning

SECTION 8



Retirement Planning Today®

Introduction

Proper estate planning gives you control over important financial and personal decisions. It can help you and your family to preserve your legacy and accomplish goals even after you pass away.

Contrary to common belief, everyone needs estate planning. Whether you are working or retired, single or married, wealthy or not, you will see that careful estate planning can benefit you!

The tax law changes that apply to estate planning have caused many people to develop an effective estate planning strategy and others to re-evaluate and update their plan.

Today, we will discuss many estate planning topics including:

- Objectives of estate planning
- Planning for incapacity
- Taxes
- Wills
- Probate
- Gifting assets
- Joint ownership of property
- Direct transfer assets
- Trusts
    - ◊ Benefits of trusts
    - ◊ Types of trusts

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Estate Planning

"In this world nothing can be said to be certain, except death and taxes"

- Benjamin Franklin

Estate planning is a process that provides control over personal matters and assets during your lifetime as well as after you pass away. Without proper planning, not only do you lose control over important decisions but the administration of your estate can become complicated and expensive.

OBJECTIVES OF ESTATE PLANNING

While alive:

- Document your intentions
- Transfer assets to the people or trusts that you choose
- Appoint a guardian to care for children (if incapacitated)
- Appoint a person to make medical decisions for you (if incapacitated)
- Appoint a person to make financial decisions for you (if incapacitated)
- Provide peace of mind

After death:

- Appoint a guardian to care for children
- Distribute your assets when, how and to whom you choose
- Provide charitable gifts to organizations
- Minimize potential expenses and taxes
- Avoid legal and financial complications as well as family disputes
- Eliminate delays
- Transfer business interests according to succession plan

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Planning for Incapacity

In many cases, if you become unable to make decisions for yourself and have not prepared the documents listed below, decisions will be made for you by law or by a person appointed by the court. After creating the following documents, you should discuss these decisions with your family, other named persons and provide medically-related documents to your primary care physician.

DURABLE POWER OF ATTORNEY

A durable power of attorney is a legal document in which you (the principal) are appointing the person or persons (attorney-in-fact) that you want to make financial decisions for you. In this document, you must specify the powers being granted and when the document becomes effective. This document should be created by an attorney and customized to meet your needs.

HEALTH CARE PROXY

Also referred to as an Advance Health Care Directive or Medical Power of Attorney, this document appoints a person (health care agent) to make health care decisions for you if you are unable to do so. This document also serves as directions for the appointed person or to limit your health care agent's power.

LIVING WILL

A living will specifically documents your wishes about being kept alive in case of terminal illness or persistent unconsciousness. A living will is also known as an Advance Health Care Directive.

DECLARATION OF ANATOMICAL GIFT FORM

This form allows you to express your wish to donate an organ(s) for transplant or your body for medical research. To learn more about making an anatomical gift visit www.organdonor.gov.

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Income Taxes

Minimizing taxes is an important part of estate planning. Without proper planning, several problems may occur:

- Surviving spouse's standard of living may be compromised
- Fewer assets may be transferred to beneficiaries
- Heirs may need to borrow or sell assets to pay taxes (estate taxes are due within 9 months of death)

INCOME TAXES

Following your death, income taxes will be due on:

- Any income you earn in the year of your death
- Income earned by your estate after your death but before all your assets are distributed
- Income in Respect of a Decedent (IRD), which includes pre-tax contributions or tax-deferred earnings from accounts such as IRAs, retirement plans or tax-deferred annuities[1]

CAPITAL GAINS TAXES

When transferring appreciated assets, capital gains taxes differ depending upon whether you gift them during your lifetime or leave them in your will:

- When appreciated assets are gifted prior to death, the person receiving the gift and then selling it will owe capital gains on the entire increase in value between what was originally paid and the sale price[2]
- When appreciated assets are inherited, their basis may be stepped up. This means that your beneficiaries may only owe capital gains on any increase in the asset value from the time of inheritance until the asset is sold.

[1] Income tax is owed by the beneficiaries when distributions are taken from the account. An income tax deduction is available for any estate tax paid on IRD assets.

[2] Gifts within 3 years of death may be considered part of the estate for estate taxation purposes.

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Transfer Taxes

GIFT TAX

The gift tax is a federal tax that may be owed if you give money or assets without receiving fair compensation. Gift taxes are only owed on gifts that exceed both the annual limit of $15,000 (2018) per recipient and the $11,200,000 lifetime gift tax exemption. In addition, only gifts that exceed the $15,000 limit reduce the $11,200,000 lifetime limit. Gifts given to a charity or spouse are generally exempt from this tax.[1]

FEDERAL ESTATE TAX

This federal tax may be placed upon your estate at the time of death based on the value of your taxable estate. Assets left to a charity or spouse are exempt from this tax.[2]

GENERATION SKIPPING TRANSFER TAX (GST)

This federal transfer tax may be imposed on a gift or inheritance to persons at least two generations younger than the person making the transfer. The generation skipping transfer tax has an exemption, which under current law, is equal to the estate tax applicable exclusion amount.

APPLICABLE EXCLUSION AMOUNT

The applicable exclusion amount is the value of the taxable estate that can pass free of transfer taxes. In 2018, the applicable exclusion amount is $11,200,000.

[1] If a married person is not a U.S. citizen, gifts or inheritances from their spouse are allowed an annual exclusion of $148,000 (2016), but the marital deduction is only available for amounts placed in Qualified Domestic Trusts.

[2] If a married person is not a U.S. citizen, inheritance from their spouse is not exempt from estate tax unless placed in a Qualified Domestic Trust.

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Transfer Taxes

PORTABILITY[1]

Portability is a relatively new concept in estate planning. It was introduced in a 2010 law and extended indefinitely in 2012. Portability allows a surviving spouse to elect to take advantage of the unused portion of the estate tax applicable exclusion amount of his or her predeceased spouse. This would provide the surviving spouse with a larger exclusion amount.[2] Portability will reduce the estate tax for many people but also has several limitations. Before planning to use portability provisions, you should consult with an estate planning attorney.

TAX EXCLUSION LIMITS & MAXIMUM TAX RATES

Year of death exclusion	*Lifetime gift tax exclusion*	*Estate tax*	*Maximum tax rate*
2018	$11,200,000	$11,200,000	40%

STATE INHERITANCE OR ESTATE TAXES

Many individual states have inheritance or estate taxes that are owed in addition to the federal tax. State rules and rates vary greatly and may not follow the federal program. You should consult with an estate planning attorney to determine if you may be subject to state inheritance or estate taxes.

[1] Portability does not apply to generation-skipping transfer (GST) taxes.

[2] An executor must file a timely, properly prepared, and completed IRS Form 706 on behalf of a decedent to make the portability election (so the deceased spousal unused exclusion amount may be available to the surviving spouse).

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Calculate Your Taxable Estate

Your taxable estate will determine how much you may owe in federal and state estate taxes. To calculate your taxable estate, add your estate's assets (using their fair market value) to determine your gross estate. Next, add your estate's liabilities and expenses to determine your allowable deductions. Finally, subtract your allowable deductions from your gross estate to determine the value of your taxable estate.

Gross estate
- Allowable deductions
Taxable estate

Estate assets	*$*	*Estate liabilities & expenses*	*$*
All assets solely owned in your name		Taxes you owe	
Half of assets owned jointly with your spouse		Outstanding debts	
Your percentage of assets owned jointly with anyone else		Estate settlement costs	
Your percentage of any business or partnership		Funeral expenses	
Assets in revocable trusts or custodial accounts (that you created in which you are trustee or custodian)		Gifts to charitable organizations (charitable deduction)	
Debts owed to you		Assets left to spouse (unlimited marital deduction)	
Life insurance death benefits (if policy is owned in your name)		Life insurance is included in the estate if the deceased is the beneficiary	
Survivor income benefits			
Annuity death benefits			
Retirement plan benefits			
Gross Estate =		**Allowable Deductions =**	

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Dying Without a Will

Everyone should have a will and an estate plan. The choice that you make is whether you want control over the distribution of your estate or if you want state law to make decisions for you.

Dying without a will is referred to as dying "intestate." In this case, once certain assets are transferred directly, a probate judge will distribute your remaining assets according to intestate succession laws of your state of residence.

DISADVANTAGES OF DYING WITHOUT A WILL

You lose control over personal decisions:

- A person or entity will be appointed to administer your estate
- A guardian will be appointed for any minor children

You lose control over when, how and to whom assets are distributed:

- All children are treated equally, regardless of their needs or your wishes
- If minor children inherit assets, the court will appoint a conservator to manage assets until children receive them upon reaching age of 18
- Distant relatives may receive assets which you intended to leave to friends or charities
- Depending upon state law, all assets may pass to your spouse and none to your children from a previous marriage
- Depending upon state law, no assets may be provided to the survivor of an unmarried couple

You lose control over the expense and time frame of estate distributions:

- Your estate may incur taxes and expenses that could have been avoided
- Your estate may experience delays and a shortage of liquid assets to pay estate taxes (due within 9 months of death)

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A Will May Not Be Enough

A will is an important legal document. In your will, you (the testator or testatrix) should provide instructions for the distribution of your estate upon your death and appoint a person (executor, executrix or personal representative) to administer your estate.

ADVANTAGES OF A WILL

Although a will by itself may not create the most effective estate plan, it does offer many advantages listed below:

- You select the person or entity (executor or personal representative) you want to carry out the terms of your will
- You indicate the persons or organizations (beneficiaries) that should receive your assets
- You provide any limitations pertaining to when and how assets will be distributed
- You select a guardian for any minor children
- You specify assets that are to be transferred into trusts upon your death
- You guarantee your estate will be submitted for probate and the administration of your estate will be supervised by the court

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A Will May Not Be Enough

DISADVANTAGES OF A WILL-ONLY ESTATE PLAN

Additional planning strategies may reduce or eliminate some of these shortfalls associated with a will-only estate plan:

- Your will is subject to probate (and associated costs) to determine if your will is valid
- Your will can be challenged and creditors can make claims on your estate
- All information about your assets will become available to the public
- Your assets will not be available to your heirs until your estate is approved by probate court (usually takes 6 months to over 2 years)

WHEN TO REVISIT YOUR WILL

Reasons you may decide to change your will include the death of a beneficiary or executor, the birth of a child, children reaching age 18, marriage or divorce, a change in your wealth, a move to a different state, new legislation or a change of mind about your executor or a beneficiary. Even if none of these situations occur, you should review your will every few years.

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Probate

FL: Difficult & Long until
3% attorney
3% representative
+ Fees.

Probate is a state, legal process to identify the value of what you own and distribute your assets following your death. If you do not have a will, assets subject to probate will be distributed according to state law. If you have a will, probate will supervise the execution of your will's instructions.

ADVANTAGES

Advantages of probate include:

- Provides a consistent legal process for people who die without a will
- Determines the validity of your will and interprets its intent
- Provides court supervision to ensure your executor is acting according to your will
- Generally limits the time in which the will can be challenged and creditors can make claims on the estate
- Pays debts and taxes, settles disputes and transfers legal title
- It does not influence any assets transferred by other methods[1]

DISADVANTAGES

Disadvantages of probate include:

- Probate related fees and expenses usually average between 3% and 8% of the value of the probated estate
- Assets subject to probate may not be available to beneficiaries or heirs during the probate period (which usually lasts from 6 months to over 2 years)
- All information about your assets will become available to the public

[1] Property distributed outside of probate may still be subject to claims of creditors and taxes

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Avoiding Probate

Due to time, expense and publicity, many people seek to have as many assets as possible transferred outside of probate. As you will see, the strategies you use to avoid probate can make a big difference in accomplishing your estate planning objectives.

Gifting While Alive

A few advantages of making gifts during your lifetime are listed below:

- Opportunity to experience the recipient enjoying your gift
- Reduce the size of your estate (and estate taxes)[1]
- Gift taxes are only owed on gifts that exceed both the annual limit and the lifetime gift tax exclusion

A few disadvantages of making gifts during your lifetime are listed below:

- Loss of potential price appreciation of gifted asset
- Loss of income from gifted asset
- Loss of control of how or when the gifted asset will be used

[1] Gifts within 3 years of death may be considered part of your estate for taxation purposes.

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Joint Ownership

Two or more people often hold joint ownership of property. Property may include real estate, a business, bank accounts, stock, etc. There are different types of joint ownership, some avoid probate and others do not.

JOINT TENANCY WITH RIGHTS OF SURVIVORSHIP

Although this type of ownership avoids probate, there are disadvantages. When two or more people own property as joint tenants, the deceased's ownership interest in the property is automatically inherited by the other owner(s) regardless of instructions in the deceased's will or living trust. Characteristics of joint tenancy are listed below.

While alive:

- Tax and estate planning ability is limited
- Other owners have access to the jointly owned asset
- Property may be subject to claims of other owners' creditors
- Potential gift tax liability

After death:

- Property avoids probate until the death of the survivor
- Cannot place restrictions on survivors
- May unintentionally disinherit heirs
- No protection from potential estate taxes

TENANCY BY THE ENTIRETY

Assets protected when one gets sued!

This somewhat outdated type of joint tenancy is still allowed in many states. It provides right of survivorship and is available only to a husband and wife. One advantage is that your residence is protected from the claims of either the husband's or wife's creditors (but not protected from joint creditors).

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Joint Ownership

TENANTS IN COMMON

When two or more people own property as tenants in common, the deceased's ownership is not automatically inherited by the other owners. Rather, it is included in the deceased's estate and distributed accordingly.

COMMUNITY PROPERTY

When living in one of nine community property states[1], property that is acquired by either spouse or both spouses during marriage is presumed to be community property unless acquired as separate property by gift or inheritance. The deceased spouse's 50% interest in community property is included in his/her estate and distributed accordingly. If held as community property, the deceased spouse's community property interest gets a step-up in basis to date of death value and the surviving spouse's community interest also gets an equal step-up.

[1] A form of community property exists in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Community property usually retains this status even if the couple moves from a community property state.

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Direct Transfer Assets

BENEFICIARY DESIGNATIONS

Certain types of assets enable you to name a beneficiary. Since the beneficiary will automatically receive the asset upon your death, the asset will avoid probate. It is important to periodically review any beneficiary designations. You may name a beneficiary for assets such as:

- Insurance policies
- Annuities
- IRA and Roth IRA accounts
- 401(k)s[1] and other types of retirement plans

PAYABLE ON DEATH ACCOUNTS

A payable on death registration[2] allows the ownership of certain assets to pass automatically to the person you name without the risks of joint ownership. The transfer of these assets avoids probate. The following types of assets may be transferred by payable on death registration:

- Bank accounts
- Certificates of deposit
- Mutual fund accounts
- Brokerage accounts

DIRECT TRANSFER ASSET CHARACTERISTICS

- Direct transfer does avoid probate
- Not available for all types of assets
- Problems may occur if minors or people who are incapacitated are named

[1] Surviving spouse has rights to 401(k) assets regardless of named beneficiary unless spouse has waived all rights to account in writing.

[2] Payable on death accounts are available in most states and may be available to people outside these states if accounts are based in states permitting payable on death designations.

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Trusts

A trust is a legal entity that can be created to hold title to assets as well as manage and distribute them according to specific terms and conditions.

DEFINITIONS

The Grantor – Also known as the Trustor or Settlor, this party creates the trust, names the trustees, beneficiaries and transfers assets or property to the trust.

The Trustee – One or more parties who hold title to trust assets and administer the trust according to specified terms and conditions for the benefit of one or more parties.

Beneficiaries – One or more parties that receive the benefits of the trust, such as income or assets, according to the terms of the trust.

Trust Agreement – A written, legal document created by the grantor that specifies the parties and terms of a trust.

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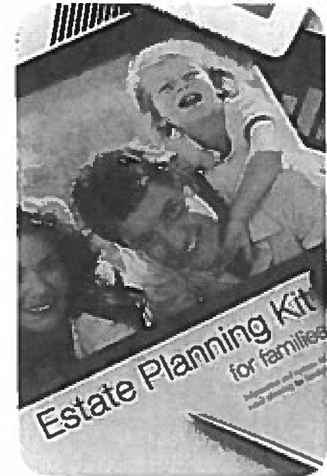
Benefits of Trusts

Various types of trusts offer many benefits including those listed below:

- Avoid probate (and associated expenses) and publicity
- Isolate and transfer assets even if your will is contested
- Distribute indivisible property among beneficiaries or equalize inheritances
- Simplify the distribution of certain assets such as property you own in a different state
- Protect assets from claims of creditors or lawsuits
- Manage assets for a beneficiary who is unable to handle financial responsibility
- Delay the transfer of ownership or possession of assets until a certain time or event
- Transfer the responsibility of managing assets or to plan for the possibility of incapacity
- Minimize or avoid income, gift and potential estate taxes



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Types of Trusts

TESTAMENTARY TRUSTS

Testamentary trusts are created by your will and are funded by your estate. These types of trusts are administered by the trustee(s) who you name in your will. Since they do not become active until you pass away, you may own and manage assets during your lifetime.

LIVING TRUSTS

Living trusts, also referred to as "inter vivo trusts," are set up and take effect while you are still living. You may serve as the trustee or you may name someone else. When designed properly, trust assets may be distributed directly or be held for the benefit of the trusts beneficiaries upon your death and avoid probate. Living trusts are designed to be either revocable or irrevocable.

REVOCABLE TRUSTS

Can change

Revocable trusts allow the grantor to revoke the trust or modify its terms. Assets can be transferred in or out of the trust without annual limitations. Assets in a revocable trust are taxed as part of your estate. The grantor may also serve as the trustee and the beneficiary during their lifetime.

IRREVOCABLE TRUSTS

Cannot change

As its name implies, once an irrevocable trust is created, it cannot be revoked or modified by the grantor. By using an irrevocable trust, the grantor surrenders control of the trust and its assets. Irrevocable trusts are often used to minimize or avoid income and potential estate taxes. Common types of irrevocable trusts include irrevocable life insurance trusts and charitable remainder trusts.

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Revocable Living Trusts

Revocable living trusts are often used to avoid probate while maintaining flexibility and control over assets during the lifetime of the grantor. Key features of revocable living trusts are listed below:

- Can make changes to terms, trustee and beneficiaries (in case of legislative changes or change of mind)
- Avoid probate[1] and publicity
- Do not save income or potential estate taxes and are not protected from grantor's creditors
- May contain provisions designed to save potential estate taxes for married couples
- At death, trust assets may be distributed to beneficiaries designated in the trust (according to the specified time frame), or may be held in further trust for their benefit
- May be used to hold assets in multiple states (and avoid multiple probates)
- May reduce the risk of your will being contested
- Assets should be transferred and owned in the name of the trust (including transferring title and obtaining a revised deed for real estate)
- A "pour over" will serve to transfer any assets outside your trust into your trust upon your death

Living Revocable Trust.

Married Trust
Dependent Trust
Dynasty Trust

[1] Since trusts avoid probate there is no court supervision over how the trustee invests, manages or distributes assets.

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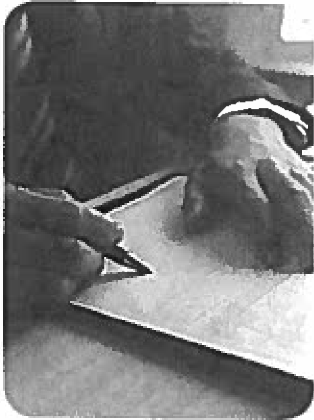
Charitable Remainder Trusts



Charitable remainder trusts may be used to provide a gift to a qualifying charity of your choice and generate a source of income for you. In addition, they help you to avoid potential estate taxes, gift taxes and probate. Key features of charitable remainder trusts include:

- Provide a source of income (paid at least annually) for your lifetime, you and your spouse's joint lifetime or your chosen beneficiary's lifetime
- A charitable income tax deduction (based on the estimated value of assets expected to pass to the charity at your death) is available for the year in which you set up the trust and contribute assets to it
- Upon your (or your beneficiary's) death, all assets in the trust are transferred to the charity you've selected
- Your charitable gift is not subject to gift taxes
- The value of the trust is excluded from your estate
- If assets held in trust are sold, no capital gains are due upon sale since the trust is tax exempt. Capital gains will be taxable to a non-charitable beneficiary if later distributed.

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Irrevocable Life Insurance Trusts

Irrevocable life insurance trusts (ILITs) are set up during your lifetime and are often used to avoid probate and shelter life insurance benefits from potential estate taxes. Key features of irrevocable life insurance trusts are listed below:

- Since this trust is irrevocable, the grantor must give up the rights to assets, to revoke or change terms and to change beneficiaries
- If the trust purchases the life insurance policy, protection from potential estate tax may be immediate
- If you transfer an existing policy into the trust, the insurance proceeds may be subject to estate taxes if you die within three years of the transfer
- Assets or insurance policies transferred to the trust may be subject to gift tax
- Since the trust owns the insurance policy and death benefits are paid to the trust, these assets avoid probate and the claims of creditors

LIQUIDITY AND ESTATE TRANSFER COSTS

Proper estate planning must address the issue of liquidity to pay expenses. Federal and state estate taxes are due within 9 months of death. Probate and funeral expenses can cost more than you might think. A few issues to consider include:

- Cash may not be available when it is needed to pay estate expenses. Remember, after-tax dollars must be used.
- Assets may need to be sold below fair market value to generate cash quickly. This can lead to family disputes over heirlooms or assets with shared ownership.
- If credit is used to borrow the money, interest must be paid in addition to principal, using after-tax dollars
- Irrevocable insurance trusts are often used to purchase insurance such as a survivorship life policy. Death benefits can be excluded from your estate, no taxes are owed and money is available to pay for estate expenses.

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