



**Investor's Resource**

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# Estate Planning Basics

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## Estate Planning — An Introduction

By definition, estate planning is a process designed to help you manage and preserve your assets while you are alive, and to conserve and control their distribution after your death according to your goals and objectives. But what estate planning means to you specifically depends on who you are. Your age, health, wealth, lifestyle, life stage, goals, and many other factors determine your particular estate planning needs. For example, you may have a small estate and may be concerned only that certain people receive particular things. A simple will is probably all you'll need. Or, you may have a large estate, and minimizing any potential estate tax impact is your foremost goal. Here, you'll need to use more sophisticated techniques in your estate plan, such as a trust.

To help you understand what estate planning means to you, the following sections address some estate planning needs that are common among some very broad groups of individuals. Think of these suggestions as simply a point in the right direction, and then seek professional advice to implement the right plan for you.

### Over 18

Since incapacity can strike anyone at anytime, all adults over 18 should consider having:

- A durable power of attorney: This document lets you name someone to manage your property for you in case you become incapacitated and cannot do so.
- An advance medical directive: The three main types of advance medical directives are (1) a living will, (2) a durable power of attorney for health care (also known as a health-care proxy), and (3) a Do Not Resuscitate order. Be aware that not all states allow each kind of medical directive, so make sure you execute one that will be effective for you.

### Young and single

If you're young and single, you may not need much estate planning. But if you have some material possessions, you should at least write a will. If you don't, the wealth you leave behind if you die will likely go to your parents, and that might not be what you would want. A will lets you leave your possessions to anyone you choose (e.g., your significant other, siblings, other relatives, or favorite charity).

### Unmarried couples

You've committed to a life partner but aren't legally married. For you, a will is essential if you want your property to pass to your partner at your death. Without a will, state law directs that only your closest relatives will inherit your property, and your partner may get nothing. If you share certain property, such as a house or car, you might consider owning the property as joint tenants with rights of survivorship. That way, when one of you dies, the jointly held property will pass to the surviving partner automatically.

### Married couples

For many years, married couples had to do careful estate planning, such as the creation of a credit shelter trust, in order to take advantage of their combined federal estate tax exclusions. A new law passed in 2010 allows the executor of a deceased spouse's estate to transfer any unused estate tax exclusion amount to the surviving spouse without such planning. This provision is effective for estates of decedents dying in 2011 and later years.

You may be inclined to rely on these portability rules for estate tax avoidance, using outright bequests to your spouse instead of traditional trust planning. However, portability should not be relied upon solely for utilization of the first to die's estate tax exemption, and a credit shelter trust created at the first spouse's death may still be advantageous for several reasons:

- Portability may be lost if the surviving spouse remarries and is later widowed again
- The trust can protect any appreciation of assets from estate tax at the second spouse's death
- The trust can provide protection of assets from the reach of the surviving spouse's creditors
- Portability does not apply to the generation-skipping transfer (GST) tax, so the trust may be needed to fully leverage the GST exemptions of both spouses

Married couples where one spouse is not a U.S. citizen have special planning concerns. The marital deduction is not allowed if the recipient spouse is a non-citizen spouse, but a \$152,000 (in 2018, \$149,000 in 2017) annual exclusion is allowed. If certain requirements



*The Tax Cuts and Jobs Act, signed into law in December 2017, doubled the gift and estate tax basic exclusion amount and the GST tax exemption to about \$11,200,000 in 2018. After 2025, they are scheduled to revert to pre-2018 levels and cut by about one-half.*

are met, however, a transfer to a qualified domestic trust (QDOT) will qualify for the marital deduction.

### **Married with children**

If you're married and have children, you and your spouse should each have your own will. For you, wills are vital because you can name a guardian for your minor children in case both of you die simultaneously. If you fail to name a guardian in your will, a court may appoint someone you might not have chosen. Furthermore, without a will, some states dictate that at your death some of your property goes to your children and not to your spouse. If minor children inherit directly, the surviving parent will need court permission to manage the money for them. You may also want to consult an attorney about establishing a trust to manage your children's assets.

You may also need life insurance. Your surviving spouse may not be able to support the family on his or her own and may need to replace your earnings to maintain the family.

### **Comfortable and looking forward to retirement**

You've accumulated some wealth and you're thinking about retirement. Here's where estate planning overlaps with retirement planning. It's just as important to plan to care for yourself during your retirement as it is to plan to provide for your beneficiaries after your death. You should keep in mind that even though Social Security may be around when you retire, those benefits alone may not provide enough income for your retirement years.

Consider saving some of your accumulated wealth using other retirement and deferred vehicles, such as an individual retirement account (IRA).

### **Wealthy and worried**

Depending on the size of your estate, you may need to be concerned about estate taxes.

Estates of \$11,200,000 (in 2018, \$5,490,000 in 2017) are effectively exempt from the federal gift and estate tax. Estates over that amount may be subject to the tax at a top rate of 40 percent.

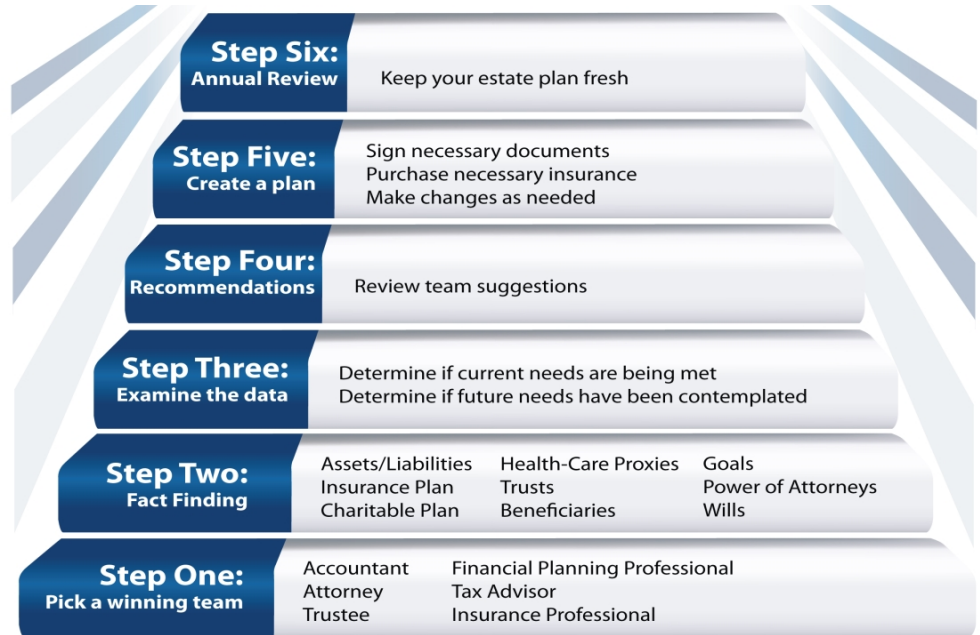
Similarly, there is another tax, called the generation-skipping transfer (GST) tax, that is imposed on transfers of wealth that are made to grandchildren (and lower generations). The GST tax exemption is \$11,200,000 (in 2018, \$5,490,000 in 2017) and the GST tax rate is 40 percent.

Whether your estate will be subject to state death taxes depends on the size of your estate and the tax laws in effect in the state in which you are domiciled.

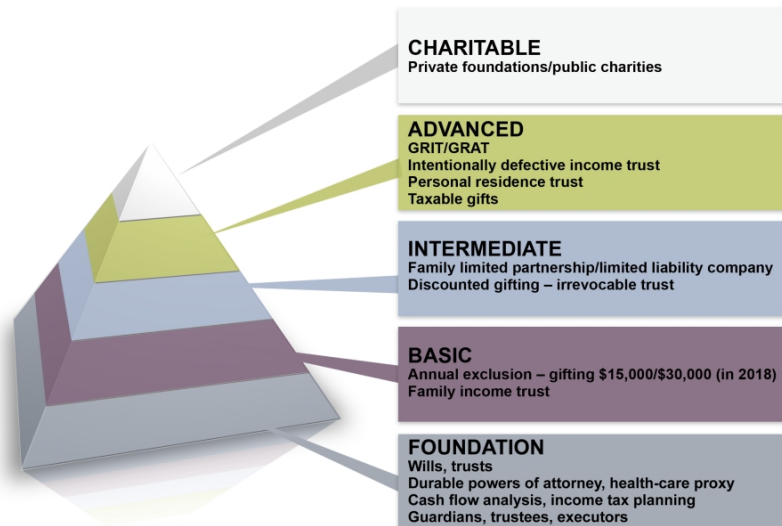
### **Elderly or ill**

If you're elderly or ill, you'll want to write a will or update your existing one, consider a revocable living trust, and make sure you have a durable power of attorney and a health-care directive. Talk with your family about your wishes, and make sure they have copies of your important papers or know where to locate them.

## Steps to Estate Planning Success



## Estate Planning Pyramid





### **What is a trust?**

*A trust is a legal entity that is created for the purpose of transferring property to a trustee for the benefit of a third person (beneficiary). The trustee manages the property for the beneficiary according to the terms specified in the trust*



*With your estate plan successfully implemented, one final but critical step remains: carrying out a periodic review and update.*

## **Advantages of Trusts**

### **Why you might consider discussing trusts with your attorney**

- Trusts may be used to minimize estate taxes for married individuals with substantial assets.
- Trusts provide management assistance for your heirs.\*
- Contingent trusts for minors (which take effect in the event that both parents die) may be used to avoid the costs of having a court-appointed guardian to manage your children's assets.
- Properly funded trusts avoid many of the administrative costs of probate (e.g., attorney fees, document filing fees).
- Generally, revocable living trusts will keep the distribution of your estate private.
- Trusts can be used to dispense income to

intermediate beneficiaries (e.g., children, elderly parents) before final property distribution.

- Trusts can ensure that assets go to your intended beneficiaries. For example, if you have children from a prior marriage you can make sure that they, as well as a current spouse, are provided for.
- Trusts can minimize income taxes by allowing the shifting of income among beneficiaries.
- Properly structured irrevocable life insurance trusts can provide liquidity for estate settlement needs while removing the policy proceeds from estate taxation at the death of the insured.

\*This is particularly important for minors and incapacitated adults who may need support, maintenance, and/or education over a long period of time, or for adults who have difficulty managing money.

## **Conducting a Periodic Review of Your Estate Plan**

With your estate plan successfully implemented, one final but critical step remains: carrying out a periodic review and update.

Imagine this: since you implemented your estate plan five years ago, you got divorced and remarried, sold your house and bought a boat to live on, sold your legal practice and invested the money that provides you with enough income so you no longer have to work, and reconciled with your estranged daughter. This scenario may look more like fantasy than reality, but imagine how these major changes over a five-year period may affect your estate. And that's without considering changes in tax laws, the stock market, the economic climate, or other external factors. After all, if the only constant is change, it isn't unreasonable to speculate that your wishes have changed, the advantages you sought have eroded or vanished, or even that new opportunities now exist that could offer a better value for your estate. A periodic review can give you peace of mind.

### **When should you conduct a review of your estate plan?**

#### ***Every year for large estates***

Those of you with large estates (i.e., more than the federal or your state's exclusion

amount, whichever is smaller) should review your plan annually or at certain life events that are suggested in the following paragraphs. Not a year goes by without significant changes in the tax laws. You need to stay on top of these to get the best results.

#### ***Every five years for small estates***

Those of you with smaller estates (under the applicable exclusion amount) need only review every five years or following changes in your life events. Your estate will not be as affected by economic factors and changes in the tax laws as a larger estate might be. However, your personal situation is bound to change, and reviewing every five years will bring your plan up to date with your current situation.

#### ***Upon changes in estate valuation***

If the value of your estate has changed more than 20 percent over the last two years, you may need to update your estate plan.

#### ***Upon economic changes***

You need to review your estate plan if there has been a change in the value of your assets or your income level or requirements, or if you are retiring.



### ***Upon changes in occupation or employment***

If you or your spouse changed jobs, you may need to make revisions in your estate plan.

### ***Upon changes in family situations***

You need to update your plan if: (1) your (or your children's or grandchildren's) marital status has changed, (2) a child (or grandchild) has been born or adopted, (3) your spouse, child, or grandchild has died, (4) you or a close family member has become ill or incapacitated, or (5) other individuals (e.g., your parents) have become dependent on you.

### ***Upon changes in your closely held business interest***

A review is in order if you have: (1) formed, purchased, or sold a closely held business, (2) reorganized or liquidated a closely held business, (3) instituted a pension plan, (4) executed a buy-sell agreement, (5) deferred compensation, or (6) changed employee benefits.

### ***Upon changes in the estate plan***

Of course, if you make a change in part of your estate plan (e.g., create a trust, execute a codicil, etc.), you should review the estate plan as a whole to ensure that it remains cohesive and effective.

### ***Upon major transactions***

Be sure to check your plan if you have: (1)

received a sizable inheritance, bequest, or similar disposition, (2) made or received substantial gifts, (3) borrowed or lent substantial amounts of money, (4) purchased, leased, or sold material assets or investments, (5) changed residences, (6) changed significant property ownership, or (7) become involved in a lawsuit.

### ***Upon changes in insurance coverage***

Making changes in your insurance coverage may change your estate planning needs or may make changes necessary. Therefore, inform your estate planning advisor if you make any change to life insurance, health insurance, disability insurance, medical insurance, liability insurance, or beneficiary designations.

### ***Upon death of trustee/executor/guardian***

If a designated trustee, executor, or guardian dies or changes his or her mind about serving, you need to revise the parts of your estate plan affected (e.g., the trust agreement and your will) to replace that individual.

### ***Upon other important changes***

None of us has a crystal ball. We can't think of all the conditions that should prompt us to review and revise our estate plans. Use your common sense. Have your feelings about charity changed? Has your son finally become financially responsible? Has your spouse's health been declining? Are your children through college now? All you need to do is give it a little thought from time to time, and take action when necessary.

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