

Guide to Estate Planning

The Need for Estate Planning

During life and at death, we all transfer property to others. Estate planning is the method by which such transfers are arranged according to our wishes.

Estate planning is often neglected, perhaps because it involves facing mortality or more immediate concerns are given priority. However, ignoring estate planning is shortsighted and may lead to unintended and costly results.

The need for estate planning is not limited to those with substantial wealth. The adverse impact of a poor estate plan is often the greatest for those of modest means.

If you die without a will, the state, in effect, makes a will for you by requiring that property titled in your name is distributed according to the ‘intestate’ statutes. The result may be different from what you intend.

Estate Planning Steps

- Prepare an inventory of all your assets, such as cash, securities, real estate, business interests, retirement benefits, partnership interests, life insurance, and significant tangible personal property. Note any liabilities.
- Consider what individuals and charitable institutions might be potential beneficiaries of your estate.
- Decide who should perform administrative tasks after your death. The individuals or financial institutions that you choose will assume what is known as a *fiduciary* responsibility. There are three separate functions you may need in your estate plan:
 1. **Personal Representative** is the term (in the past described as the executor) for the person or financial institution, or both, responsible for handling your affairs immediately upon your death. The personal representative can be a spouse, friend, professional advisor, a bank or a similar institution.
 2. **Guardian** is the individual responsible for the physical custody and care of your minor children. While this could be the same person as your personal representative or trustee, it is clearly a different duty. This is the person you would expect to replace you as a parent.
 3. **Trustee** is the individual or financial institution, or both, charged with managing assets you have placed in trust for the benefit of another. A trustee is responsible for overseeing the investment and preservation of the trust assets and must distribute the assets as directed by the trust.

Basic Estate Planning Documents

To accomplish your estate planning goals, one or more of the following estate planning documents may be appropriate:

- **Will** Your will takes effect only at your death to dispose of property held in your name alone. You may change your will at any time. A codicil is a document that amends parts of your will without revising the entire document.
- **Trust** A Trust is an arrangement where a person or entity (the “trustee”) manages property for the benefit for another person (the “beneficiary”). Trusts may be divided into three types:
 - **Revocable** Since you may change a revocable trust at any time, it is similar to a will. The primary advantages of a revocable trust estate plan are that trust assets may be managed during any period of incompetence or incapacity without a court supervised conservatorship. Trust assets may be distributed privately after your death without the necessity of probate.
 - **Irrevocable** An irrevocable trust may not be change; it is used to make a completed gift when you do not want the recipient to have outright ownership immediately.
 - **Testamentary** Unlike revocable and irrevocable trusts, which take effect when you transfer property to a trustee, a testamentary trust is created by your will and becomes effective when you die.
- **Durable General Power of Attorney** A power of attorney authorizes another person (the “attorney-in-fact”) to manage your financial affairs. A general power of attorney allows that person to handle all of your financial affairs. A general power of attorney may be durable, which means that it will continue to be valid if you become incompetent.
- **Health Care Directive** A health care directive (in some states this is known as a Living Will) allows you to:
 - Authorize another person to make health care decisions for you if you cannot make and communicate them;
 - Provide directions your care; and
 - Communicate your wishes about where and from whom you will receive care, organ donations, and choices about your funeral and burial.

Title to Assets

There is considerable misunderstanding about how title to assets should be held and about the distinctions among and advantages or disadvantages of “probate” property, “non-probate” property and property held in an “living” or revocable trust.

Assets Titled in Your Name Alone In the estate planning context, assets in one name alone are referred to as “probate property.” This property is transferred according to the terms of your will. For example, if you own stock in XYZ Corporation in your name alone, and your will states that it is to be given to your oldest child, the stock will be transferred as a part of the administration of your estate.

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Other Asset Titles It is also possible to title property with a named beneficiary. These assets or “non-probate property,” are not governed by your will. For example, if you buy 100 shares of XYZ Corporation stock and name your spouse as a joint tenant, then your spouse becomes owner of all of those shares upon your death, even if your will provides otherwise. Typical examples of such assets are jointly owned residences, assets held in a revocable trust, life insurance contracts and qualified retirement plans, including IRAs, which pass directly to the designated beneficiary(ies) of the plan.

Naming a spouse as joint tenant or as a beneficiary of an insurance policy or retirement plan is a common way to transfer title. However, a potential risk is that an unnecessary estate tax liability may be created upon your spouse’s death, if he or she has a taxable estate over the amount exempt from estate tax.

Estate and Gift Taxes

When the value of assets exceeds a certain level, it is important to develop an estate plan that, to the extent possible, minimizes the overall tax burden.

Both the federal and most state governments impose a tax on the transfer of assets, whether the transfer is made during an individual’s life or at death. The nature and rates of these taxes have been changed countless times since they were initially adopted.

Applicable Exclusion Amount For federal purposes, each person may transfer (by lifetime gift or at death) a certain amount of property free of gift and estate taxes. As of January 1, 2005, the amount of transfer that one can make free of gift tax during a lifetime is \$1,000,000. However, the amount transferable free of federal estate tax at death is \$1,500,000. Whatever part of the applicable exclusion amount for gifts is used, reduces the applicable exclusion amount for estate transfers. The amount transferable free of gift tax is not scheduled to increase; however, the amount transferable free of estate tax at death increases incrementally to \$3,500,000 by 2009. For the year 2010 only, the estate tax is repealed. In 2011, the amount transferable free of estate tax reverts to \$1,000,000. (Congress is likely to address estate taxes before 2011 and reach a different solution.)

If you make taxable gifts during your lifetime, you will pay no gift tax if the gifts total less than \$1,000,000, and you may still transfer an amount equal to your remaining applicable exclusion amount for estate transfers tax-free at your death. If you make no taxable gifts during your lifetime, the entire applicable exclusion amount for estate transfers may be transferred tax-free at your death. Without proper planning, a husband and wife may fail to use both applicable exclusion amounts and may pay more estate tax than is necessary. To properly use both applicable exclusion amounts, the first spouse to die must have (i) separate assets titled in his or her sole name, and (ii) special trust provisions in his or her estate plan.

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As estate tax rules differ state to state, it is necessary to check with appropriate resources or state agencies for information on determining how your state's estate tax is calculated.

Unlimited Marital Deduction Generally, all transfers between spouses either during lifetime or at death are tax-free regardless of the size of the transfer. This is called the marital deduction and is in addition to the applicable exclusion amount. There are different rules if the spouse receiving property is not a U.S. citizen.

Annual Exclusion There is an annual (i.e., available each year) exclusion from gift taxes for the first \$11,000 given to any individual. The number of individuals to whom \$11,000 may be given each year tax free is unlimited. For example, a husband and wife could each give \$11,000 to each of their two children and to each of their four grandchildren, for a total of \$132,000 free of gift tax for each year. Alternatively, one spouse may give up to \$22,000 per individual without gift tax so long as the other spouse joins in the gift. This "gift splitting" is done by filing a gift tax return signed by both spouses for the year of the gift. If a gift to an individual exceeds the annual exclusion, then the excess will be counted against the \$1,000,000 applicable exclusion amount. The annual exclusion amounts have been indexed to keep up with inflation. With proper planning, annual exclusions gifts for many donees can be made to a single trust.

Gift Taxes The federal government taxes lifetime gifts in excess of a cumulative amount of \$1,000,000. The tax rate is the same as the estate tax rate. As gift tax rules differ state to state, it is necessary to check with appropriate resources or state agencies for information on determining how your state's gift tax is handled.

The Need For Review

Estate planning is an on-going process. An estate plan should be reviewed periodically to be sure that it fits the present situation.