



Estate Planning

Estate Planning Basics

Estate Planning can help you to preserve your earned assets and ensure that they go where you want them to go after you die. By taking an active approach to planning your estate you can save your family and your heir's time, expense and grief, by eliminating the uncertainty around inheritance. Only by planning your estate will you be able to be sure that your wishes will be known and respected after you pass.

What is Estate Planning?

Estate planning is the process of ensuring that the assets you have accumulated over the course of your lifetime will go where you desire and not to the government or a government program. Estate planning can be a relatively simple process in which a person works with a lawyer to produce the following documents:

- **Will** – a will is a legal document which outlines the rights and responsibilities of others for your property and / or minor children, disabled dependents in the event of your death.
- **Planning Directives** – A will covers only a certain set of your assets. Planning directives are documents that support a will by covering financial and legal issues that a will does not. Planning Directives provide directions for what should happen to your estate if a catastrophic accident or illness renders you incapable of expressing your wishes.

At the very least, each of us should have the above documents in place to protect assets in the event of death. For some people though, especially if they have larger estates, planning may need to involve additional elements such as:

- **Assignment of guardians:** For children under 18, a guardian should be assigned to take care of them.
- **Life insurance and long-term care:** You should always plan for an unplannable, catastrophic illness that can catch you off guard and put your lifesavings at risk.
- **Trusts:** If your estate is on the larger side then you might want to establish a trust to shield and protect assets.
- **Gifts:** Estate planning will help you to make gifts to those whom you intend to get them such as charities or other institutions.
- **Business:** Estate planning will help to ensure that any business you own transitions hands smoothly upon the event of your passing away.

Who needs Estate Planning?



Estate planning is not just for those who are currently millionaires; it is for anyone who cares about what will happen to their assets after they die. Here are a few categories of individuals that should have an estate plan:

- **Married couples** – Each spouse needs to have a separate will. Joint wills create legal issues if you die within weeks or months of each other.
- **Divorced couples** – To make sure your assets go to your *current* desired recipients you need to have a plan to make sure your assets pass to your children, and not to a former spouse and / or their new partner's children.
- **Business owners** – This succession plan should specify what you desire to happen to your business and the equity in the business when you pass. Another good rule of thumb is that you should make sure there is enough cash on hand to survive the transfer into new ownership for a while.
- **Current and Future millionaires** – In 2011 the estate tax will provide an exemption for estates valued at \$1 million. In general terms, if your estate totals \$1 million or more now, or has a strong possibility of exceeding \$1 million when you pass, then you should establish trusts to protect the assets that are beyond the \$1 million dollar mark. To evaluate whether you'll have \$1 million in assets when you die, you should consider the current value of your real estate property, retirement plans, savings, investments, potential inheritances, and other personal property such as jewelry, cars, etc. Then allow for the appreciation of these assets over a period of 10-20 years of possible 50 – 100%. *Note – this would depend upon the current economic environment.

Estate Planning Check List 101

Estate planning begins with some of the following steps:

1. **Listing your assets:** make a list of everything you own to include: bank accounts, investments, real estate, insurance policies, personal property and other valuables. Split the assets into two categories, one with a named beneficiary such as insurance or retirement plans, and two for jointly held assets and assets held personally that *do not* have beneficiaries.
2. **Assigning beneficiaries and heirs:** This is simply determining who you would like to pass your assets onto.
3. **A will:** Working with your lawyer, write a will that will specify where your assets should go and whom are the guardians for any under 18 aged children.
4. **Planning directives:** Working with your lawyer, you will write a living will, assign powers of attorney and develop letters of instruction for possible personal property not addressed in the will.



5. **Probate:** Understand probate, how it works and how to avoid making estate planning mistakes that can deplete the value of your estate.
6. **Establish trusts:** Working with a lawyer or a financial advisor to determine if a trust is right for your situation.
7. **Life Insurance:** Pass additional wealth and protect your heirs from potential financial catastrophe if you should die accidentally and unexpectedly.
8. **Charitable giving and family giving:** Consider whom you want to benefit from the giving of your assets to charity or heirs.
9. **General Gifting:** You can give assets to anyone you chose, gifts are usually tax free up until a specified annual and lifetime limit.
10. **Long Term Care:** You should always consider LTC insurance and determine with your advisor if it is right for you. Statistically in the upcoming decades one out of two people will need LTC and if unplanned for this will quickly deplete any lifetime accumulated personal assets.
11. **Planning the future of your business:** Planning for the sale or transfer of your business upon your passing, and cash reserves set aside for the time period of adjustment.

How Estate Taxes Work

If you give 100% of your estate to your spouse then no tax consequence arises. If anyone else other than a spouse receives assets from an estate, tax liabilities arise. The five main types of taxes that may arise for your estate or heirs are:

- Federal estate taxes (might be known as death tax)
- Federal and State Income Taxes
- State estate taxes
- State Inheritance taxes
- Capital gains taxes

Wills and Estate Planning

A will is a document used to direct where your real property and cash property assets will go when you die.

- Real property – Home, land, and any other real estate owned.
- Cash-equivalent – Assets that can be readily liquidated such as stocks, bonds, CD's and mutual funds, possibly gold, not held in retirement accounts. Assets that are *not* cash-equivalent include life insurance and annuities.



What Wills Do Not Cover

- **Personal Property** – Cars, jewelry, clothes, cash in the house, furniture, high end toys such as boats, jet skies, etc. To direct these assets to heirs you would likely need to prepare letters of instruction. Check with your attorney who will know what your state regulations and requirements are.
- **Assets with designated beneficiaries** – Insurance, annuities, pension plans, IRA's, or anything else that requires you to name a beneficiary.
- **Assets inside a trust** – Remember you do not legally own any assets that are inside a trust, so you cannot will those assets.

State “Default” Wills

Each state has a “default” will that applies to people who might die intestate, which means without a will. This default will direct assets not already assigned to named beneficiaries or held jointly with another person. Here is the order in which “default” wills will distribute assets:

- Spouse and children
- Parents and siblings
- Grandparents, aunts, uncles, nieces, nephews and cousins
- To the state if the above relatives are unable to be located

Also keep in mind the state will consider any court costs required to settle your assets. Again, work with a lawyer to determine your needs and level of required documents in order to protect your assets.

Planning Directives

Almost everyone who has a will also will also want to have planning directives. These documents are powers of attorney, letters of instruction and living wills and will provide the guidance to make sure your wishes are honored in those certain situations. These documents address issues such as:

- Financial management
- Medical care
- Distribution of personal property
- Not real estate
- Other instructions not covered by wills



Note – not all states will honor all directives, but directives none the less will provide guidance for your executor and family members. Again work with a lawyer for these documents.

Powers of Attorney

A power of attorney will allow you to name a person called an agent who can act for you in certain situations or circumstances. Powers of attorney are also called durable powers because they will be in force unless you revoke or cancel them. There are two primary types of durable powers of attorney:

- **Durable general powers of attorney** – In which you will name an agent who will make decisions for you as if they were you. Keep in mind this person can sign checks, change your accounts, etc. These usually will come into play if someone is incapacitated.
- **Durable limited power of attorney** - Names an agent but only in specific situations or for specific transactions. For example, someone you name who will act in your behalf in financial transactions or durable medical powers of attorney which enable someone to act in your behalf in regards to medical decisions.

A Living Will

A living will is a document that will state in advance *the type of care* you will receive in the event you become terminally ill or suffer a catastrophic event such as a stroke or aneurism that leaves you unable to communicate.

However, a living will can only provide guidance to medical personnel for specific situations and does not authorize someone to make decisions for you.

DNR – Do Not Resuscitate Orders

A DNR is a directive which states you desire not to have CPR or any other heart starting applications should you stop breathing. All states and personnel are required to honor these directives.

Letters of Instruction – A letter of instruction will specify to whom you would like to give personal property that is either not assigned a beneficiary or addressed in a will. These are usually used to address personal collectables such as jewelry, art or maybe coin collections and other collections.



Probate

The assets covered by your will and directives will not automatically pass to the designated heir, first they must prove:

- The will is still valid
- The asset is indeed owned by the person listed in the will
- There are no claims, liens or debts against the estate

Usually, the executor will prove these points above to the court and some states may allow for an informal probate which requires no court appearance. However, keep in mind probate can take up to 6 months to even possibly a couple of years.

Cost of Probate

When all the costs are added up—and those may include appraisal costs, Personal Representative fees, court costs, costs for a type of insurance policy known as a Surety Bond, legal and accounting fees—probate can easily cost from 3–7% of the total estate value, or more. Some of these costs are set by law, so there is not much you can do about it, but you may be able to negotiate a lower fee for services like accounting, legal advice, real estate services, etc.

Assets Subject to Probate

- Stocks, Bonds, Mutual Funds, and other investments
- Checking, Savings, CD's, and other cash accounts
- Assets which you personally and currently hold the title to, such as: homes, land, cars, etc.
- Property owned as joint tenants
- Your share of a business or businesses owned
- Insurance benefits paid to your estate

The only way to protect these assets from probate is to have them put into a trust.

Assets NOT Subject to Probate

Assets with a named beneficiary or a joint ownership do not go through the probate process:

- Annuities
- Joint owned property
- Assets that are Payable on death (POD)
- Life insurance with a named beneficiary other than your estate
- Assets in a retirement plan (401k), IRA, SEP-IRA



Why is it important to understand the different types of assets and which ones will have to go through probate?

When planning your estate let's look at an example that can illustrate this point:

Let's say you have two children, to one you leave \$100,000 in a retirement fund with them named as the beneficiary, and to the other child you leave \$100,000 in a stock account. Do you realize that the second child's entire inheritance, which was in a stock account, is now subject and must go through probate while the first child will avoid the costs and stress of probate completely.

Now keep in mind that if the estate is larger than the allowable exemption amounts assets that avoid probate will still possibly be subject to inheritance taxes and this will depend on if the income is considered ordinary income or capital gains.

The main exception to this issue would be life insurance, which is received tax free if it goes to a named beneficiary or is paid inside an irrevocable life insurance trust. Make sure to consult an attorney and a tax professional to help you analysis your specific situation.

Trusts

Types of Trusts

Trusts will fall into two main categories: revocable and irrevocable. Revocable trusts, also can be known as living trusts, can be cancelled or modified at any point during your lifetime. Irrevocable trusts are "set in stone" and cannot be cancelled. All revocable trusts will automatically become an irrevocable trust upon the death of the grantor.

Revocable Trusts

Most often used to:

- Avoid probate on larger assets such as a home and other real estate
- Preserve the full unified credit – the amount of tax exemption your estate gets – 2011 \$1 million per individual
- Allow grantor, trustee, and beneficiary to be the same person (on certain assets)

With a revocable trust the grantor must re-title major assets to transfer ownership to the trust. This approach works because changing ownership while you are living probates, or proves, that you own the assets. A good point is that often it is recommended that a revocable trust should be



accompanied by a pour-over directive, which will address assets that are not owned by the trust at the time of the grantor's death.

Irrevocable Trusts

There are different types of irrevocable trusts; these also share two key characteristics:

- Once established cannot be altered
- Grantor cannot also be both the trustee and the beneficiary

Three important types of irrevocable trusts:

- Irrevocable income-only trusts – trusts where the grantor transfers assets on a permanent basis. Once the assets are in the trust they cannot be removed, though the grantor can continue to receive the income that the trust generates. When the grantor dies the trust's remaining assets go to the grantor's named beneficiaries.

These trusts are most often used for the following goals: reduce assets subject to Medicaid eligibility limits, plan for long-term care income needs, shield assets from creditors, and ensure that funds are available for disabled dependents.

- Irrevocable life insurance trusts- create an estate for your heirs using life insurance, shield life insurance payouts from estate tax replace assets given to charities or placed in irrevocable income-only trusts. With life insurance if you name your estate as the beneficiary of your life insurance policy then the proceeds of the policy will become part of the taxable estate. A way to avoid this tax exposure is to transfer life insurance policies into an irrevocable life insurance trust. The value of the insurance remains outside your estate but you can name a beneficiary for the trust. This type of trust is a great vehicle to replace any assets that get donated to charities by providing a lump sum payment to the trust when you pass.
- Generations skipping trusts – these are used to extend the credit amount for federal estate taxes, allow remaining assets to pass onto future generations and provide income to your immediate heirs. With this type of trust, your immediate heirs *do not* own the assets in your estate, which means that no estate taxes will be due upon your death. But your immediate heirs will get the income from the assets in the trust and then when they pass, the assets will go to grandchildren. This causes the estate taxes to be deferred by a generation, thus allowing your assets to grow for decades without being exposed to diminishing estate taxes.



Life Insurance

Life insurance is a great way to give assets to a beneficiary, tax free and avoiding probate and the fees.

With life insurance you pay a related, health related scaled fee monthly, until age 100, or varying terms in between depending upon policy, and in return your beneficiary would receive a lump sum payment upon your death.

There are many financially sound reasons to purchase life insurance such as: creating an estate, replacing assets donated to charity, providing cash needed settle your estate, cover your estate's tax burden. Life insurance is a great tool to help you leave assets to your beneficiaries especially if you haven't acquired significant assets during your lifetime it will enable you to actually create wealth to pass.

Charitable Giving

Charitable giving is a great way to give back to those you want to benefit from your financial assistance after you pass. Giving to charity also provides current benefits such as: current tax deductions, reductions in capital gains and estate taxes due upon your death.

A charitable trust which is usually called a charitable remainder trust offers the grantor the option to donate assets to a charity upon death and also receive income and tax benefits during their lives. These trusts will also help to reduce the size of your estate by shielding portions of the assets from future estate tax. There are two main beneficiaries in a charitable trust: income beneficiaries and death benefit beneficiary. An income beneficiary will receive income from the trust generated during your lifetime for a specified period of time. Death benefit beneficiary will receive the remained of the trust following either the end of the trust term or the death of the income beneficiary.

General Gifting

Gifting helps the grantor to: pass money from one generation to the next, give money to organizations, provide financial aid, set up educational savings plans.

The Gift Tax



When the fair market value of a gift to any one individual person exceeds \$12,000.00 in a single year, or the total of gifts you give go beyond this \$12,000 annual limit and exceed \$1 million over your lifetime, you will have to pay a gift tax. Paying the gift tax is simple, file a gift tax return. Gift tax rates are usually around 45-50%. If a gift is below the annual limit of \$12,000 then no tax return is required.

Long Term Care

LTC covers a variety of situations; nursing home care, group care, home health care, assisted living, adult day care, and respite care. LTC can be expensive if not purchase early, and cost vary depending upon location. The most ideal time to purchase your LTC policy would be late 40's to very early 60's. Develop a strategy for your LTC needs with a financial advisor who specializes in this area, as the guidelines and variables can be complex and with a lot of moving parts.

Medicaid Planning

Medicaid is a federal government based plan intended to pay the medical costs for low-income families and individuals. It is possible to qualify for Medicaid by transferring assets to certain irrevocable trusts, such as irrevocable income trusts, and this is often referred to as a Medicaid planning tool.

Here are some points for Medicaid Planning

- The trusts you will need to establish will almost always be irrevocable meaning that the assets in them cannot be taken out.
- THE LTC facilities that take Medicaid patients will most likely be less appealing than a private pay facility.
- Medicaid plans may not cover in-home care, adult day care, or other types of care.
- To qualify for Medicaid the government usually uses a five-year look back period. The purpose if this look back period is to examine what you have done with assets that may or may not disqualify you from Medicaid eligibility.

Business Succession Planning



Most often a person who is self employed has as one of their main assets the business itself. If it is a goal to pass the business to the next generation or designated person then a carefully designed succession plan will give a predetermined strategy in the event of the principles passing.

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