

30. Understanding Estate Planning

Introduction

Estate planning is the process of planning for the accumulation, conservation, and distribution of estate assets. This process should be used to help you accomplish your personal and family goals. Every estate is eventually planned, either through planning done by an individual for his or her estate or by default through rules established by the state and local governments. The purpose of estate planning is to ensure that you—and not others, such as the government or lawyers—choose who will inherit your wealth. Through proper estate planning, you can take care of those you love even after you die. The LDS Church’s family guidebook states the following:

Brigham Young once said, “A fool can earn money; but it takes a wise man to save and dispose of it to his own advantage.” . . . Estate planning is the way we manage our major financial resources and properties to “dispose of it to [our] own advantage.” . . . This kind of planning, begun early in life, can help provide financial security for a family throughout several generations.¹

Objectives

When you have completed this chapter, you should be able to do the following:

1. Understand the principles of proper estate-planning
2. Understand the importance and goals of estate planning
3. Understand the estate-planning process
4. Know how trusts can be used to your advantage in the estate-planning process
5. Understand the importance of wills and probate planning

Understand the Principles of Proper Estate-Planning

The following are a few important principles of estate planning:

1. Understand Yourself, Your Vision, Goals and Plans. What is your vision for estate planning? What would you like to accomplish? What are your personal and family goals? Make sure what you are planning to do is in the best long-term interest of those you love.

What is your budget and balance sheet? Is what you are planning to do reasonable in light of your available resources? Will it still allow you to live in an acceptable manner for the rest of your life?

2. Understand the Estate-Planning Process and All Applicable Laws. Once you understand what you want to accomplish, you must next understand the estate-planning process and applicable laws. Make sure what you are doing is legal. Recognize the tax consequences of your actions and plan for adequate liquidity to meet your tax needs.

3. Start Early and Seek Qualified Legal Help. Start estate planning early. Once you are married, write a will to make sure your assets will go to who you want. Once you have children, make sure you articulate who you want to be the guardian of your children and executor of your will. As your assets reach a critical mass, determine how you want to dispose of those assets, and do so in a way that is consistent with your goals and objectives.

Seek qualified legal help in this process. Make sure the legal documents are well written and will accomplish the goals you want to accomplish. Realize that if you have assets in multiple states, you may need legal help in each state.

4. Remember the Key Principles of Finance. Remember the key principles of finance: Ownership: none of what we have is ours. Stewardship: we are stewards over all God has and will bless us with. Agency: the gift of choice is one of God's greatest gifts. And accountability: we will be held accountable for all of our choices, including our financial ones.

Understand the Importance and Goals of Estate Planning

The purpose of estate planning is to help us achieve our personal and family goals even after we die. Estate planning ensures that your wealth will go to those you want it to go to, so you can achieve your personal goals even after you are gone. Proper estate planning can even significantly reduce the taxes paid to Uncle Sam, thus ensuring that your heirs get a larger inheritance.

There are five main goals of estate planning:

1. Live Life Fully

To live life fully, you must provide for yourself as well as for others for whom you are responsible. You must account for the possibility that you may die prematurely. One of the main ways of managing the risk of premature death is to buy life insurance, which we discussed earlier. There are two main types of life insurance. Term life insurance provides a simple death benefit with no accumulation of cash value but significantly lower premiums. Cash-value policies offer a death benefit plus a cash-value component that grows, tax-deferred, over time and cannot be canceled. For more information on life insurance, see **Chapter 13. Insurance 3: Health, Long-Term Care, and Disability Insurance.**

In order to live life fully, you also need to plan for the possibility that you may become unable to provide for yourself. Medical-advance directives cover this possibility by allowing you to

establish a living will and/or designate the special power of attorney for health-care, which gives someone else the power to make medical decisions for you should you become unable to make them for yourself. Exercise caution when establishing powers of attorney, such as durable power of attorney, special power of attorney, or general power of attorney. Someone who has your power of attorney can do anything you can do, including sell your house and your car and enter into agreements. An example of a medical-advance directive is found in **Learning Tool 14: Utah Advance Health Care Directive**.

2. Pass Property at Death According to Your Desires

There are four ways to designate how property should be divided after you die: by will, by law, by contract, or by trust.

Pass on property at death by will: A will is a legal document that specifies your desires at the time of your death and allows your desires to be enforced. Wills permit you to appoint a personal representative to act on your behalf, appoint guardians for your minor children, appoint conservators for the assets of your minor children, and provide for disposition of your property at death. In some states, wills allow you to keep a separate updated list of tangible personal property dispositions, so you do not have to write a new will each time you decide to give something to someone else.

Current wills can revoke or change earlier wills. A will is necessary to disinherit a presumed heir, and a will can create a testamentary trust, a trust that is to be set up when you die. Unfortunately, creating a will does not avoid probate, even if the will creates a testamentary trust.

Some states, including Utah, consider holographic wills to be valid. A holographic will must be made completely in your own handwriting. It must include the date at the top and your signature at the bottom. Within the holographic will, you must name a guardian, alternate guardians, and how you would like your assets divided among your heirs. It is not necessary to have either a notary or witnesses. Be careful if you decide to create a holographic will, however. You should consider consulting an attorney about the language, and you should use a holographic will only if you do not have significant assets or a complicated family situation. Remember that a will does not avoid probate.

Pass on property at death by law: If you fail to write a will, the state will write your will for you upon your death. Through this process, known as intestacy, the state tries to determine what your will would have been had you written a will for yourself.

For example, in Utah, if a deceased person with no will has no children, the surviving spouse is given 100 percent of the deceased's assets. If the deceased has children by a prior relationship, the surviving spouse gets the first \$50,000 and half of the remaining assets. If there is no surviving spouse, the assets go to each of the children on a per capita basis at each generation. If there are no children, the assets go to parents, then to the parents' descendants, and so on.

Pass property at death by contract: Third-party contracts and deeds are two examples of contracts to disperse property upon death. Examples of third-party contracts include insurance, pay-on-death accounts, IRAs, and pension plans. Contractual deeds can either be in the form of joint tenancy, which grants rights of survivorship (i.e., the property goes to the surviving tenant), or tenancy-in-common, which grants no such rights of survivorship (i.e., the property goes to whoever is stated in the contract). Although contracts do avoid probate, they do not avoid tax consequences.

Having a contractual deed for joint-tenancy with a non-spouse may not be a good idea because it circumvents will and trust provisions. This contract creates a gift for tax purposes when a non-spouse's name is added. A joint-tenancy contract postpones probate only until the second joint-tenant dies. It also may create problems for the new tenant because of taxes on capital gains income. Additional problems may occur if one joint-tenant becomes incompetent because the asset cannot be sold or disposed of under this contract. Creating a joint-tenancy with a person who is not your spouse causes loss of control.

Pass on property at death by trust: There are many advantages to passing on property by way of trusts. Trusts are legal entities that are allowed, by law, to hold assets. Specific types of trusts may reduce or eliminate estate taxes, allow for privacy, and facilitate advanced planning. Trusts may be used as a means of handling complex family situations.

3. Provide for Guardianship of Minor Children

For most parents, the most important part of estate planning is providing for guardianship of children who are still minors. You must answer the question, if your spouse and you were to die, who would take care of your children and raise them the way you would want them to be raised? In addition, you must ask yourself, who would take care of your children's assets until the children are old enough and wise enough to manage these assets themselves?

4. Avoid Probate If Desired, or Use Probate Strategically

Probate is the legal process by which an asset's title is transferred after an individual's death. One concern many individuals have regarding probate is that the records of the assets, including information about who owns the assets, are open to public view. Anyone who reviews the public records gains access to the information.

Probate is not necessarily bad, and it is often necessary to pass on an asset's title. However, if it is important that information about ownership not be available to the public, advance planning and the use of various estate-planning tools can be helpful in avoiding probate.

5. Avoid Taxes

The final reason for estate planning is to avoid taxes. There are many legal ways to save substantially on estate and gift taxes. A few ideas will be discussed later.

Understand the Estate-Planning Process

There are four steps in the estate-planning process:

1. Determine how much your estate is worth.
2. Choose your heirs and decide which assets they will receive.
3. Determine the cash needs of the estate and calculate your estate taxes.
4. Select and implement estate-planning techniques to maximize the money going toward your personal and family goals and to minimize taxes.

Estate planning helps you use your assets wisely in order to achieve your personal goals even after your death. If you prepare well before you die, there is a greater chance you will be able to achieve your personal and family goals even after your death.

Step 1: Determine What Your Estate Is Worth

The worth of an estate is basically the difference between the value of the estate's assets and the value of the estate's liabilities. However, there are a number of steps for calculating the value of your estate.

First, calculate the gross value of the estate. This is the combined value of all estate assets, including pensions, investments, and any real or personal property. The gross value also includes life insurance proceeds payable to your estate or, if you own the policy, to your heirs; the value of certain annuities payable to your estate or heirs; and the value of certain properties you have transferred within three years of your death. The government counts assets gifted to others in the last three years of your life as part of your estate.

Second, calculate the taxable estate. This is equal to the gross value of the estate minus estimated funeral and administrative expenses, debts, liabilities, taxes, and any marital or charitable deductions.

Third, calculate the gift-adjusted taxable estate. This is equal to your taxable estate plus any taxable lifetime gifts (the cumulative total of all gifts over the annual limit). This will be discussed later. The adjusted taxable gifts are the total amount of the taxable gifts you made after 1976 that are not included in the gross value of your estate.

Step 2: Choose Your Heirs and Decide What They Will Receive

In making these decisions, remember the long-term goals for you and your family and use your financial resources to help you achieve these personal goals. Make these decisions with much thought and prayer.

Step 3: Determine the Cash Needs of Your Estate and Calculate Your Estate Taxes

Determining the cash needs of the estate is the process of making sure there will be sufficient

cash available to pay the necessary debts, bills, and taxes. If the estate is large, there must be sufficient liquid assets available to pay the required estate taxes, which may be high.

Estate taxes are equal to the gift-adjusted taxable estate multiplied by the appropriate tax rate. To determine the net tax owed, calculate the total tax owed and subtract the unified gift-tax and estate-tax credit (this is discussed in more detail later in the chapter). Ensure that you have adequate liquidity available to your heirs. Term or cash-value life insurance may be used as a tool to ensure sufficient liquidity for paying estate taxes.

Step 4: Select and Implement Your Estate-Planning Techniques

If you prepare well before your death, your estate will do well after you have died. Generally, qualified legal help is critical to help you determine and implement the best estate-planning vehicles. Remember that these vehicles are not useful until they are funded.

Four Key Taxes on Estates

There are four key taxes on estates:

1. Estate taxes, or inheritance taxes, are taxes that must be paid on an estate that has a value greater than a government-determined exclusion amount. An estate tax return for a U.S. citizen or resident needs to be filed only if the gross estate value exceeds the exclusion amount that has been determined by the government in the year of the citizen or resident's death (see Table 1). For example, if John Smith died in 2017 and his estate was valued at less than \$5.49 million, John's estate would not be required to pay estate taxes because its value is less than the estate tax exclusion amount for 2017.

2. Gift taxes: Gift taxes apply to the transfer of any property, including money, in the form of a gift. If you sell something at less than its full value, if you make an interest-free or reduced-interest loan, or if you allow the free use of your property or income from your property, you may be giving a gift. Gift taxes are taxes paid on gifts of property or money that exceed the annual exclusion, which is \$14,000 per individual (or \$28,000 per couple) in 2017. This amount can be divided and given to an unlimited number of people without incurring federal gift taxes. In the future, the \$14,000 exclusion amount will be indexed to account for inflation; the exclusion amount will increase in \$1,000 increments. A gift tax must be paid on all transfers to others (other than a spouse) that are in excess of the maximums listed in Table 4.

Tax Implications of Defined-Contribution Plans

If your company offers a defined-contribution plan, there are several tax implications you should be aware of:

Table 1. Estate Tax Limits

Year	Exclusion Amounts	Top Tax Rate
2002-2003	\$1,000,000	50%, 49%
2004-2005	\$1,500,000	48%, 47%
2006-2008	\$2,000,000	46%, 45%, 45%
2010	Eliminated	
2011	\$5,000,000	35%
2012	\$5,120,000	35%
2013	\$5,250,000	40%
2014	\$5,340,000	40%
2015	\$5,430,000	40%
2016	\$5,450,000	40%
2017	\$5,490,000	40%

Table 2. Unified Estate Tax and Gift Tax Rates

If Amount Is Over	But Not Over	Tax on Column A	Rate on Excess Over A
\$0	\$10,000	\$0	18%
\$10,000	\$20,000	\$1,800	20%
\$20,000	\$40,000	\$3,800	22%
\$40,000	\$60,000	\$8,200	24%
\$60,000	\$80,000	\$13,000	26%
\$80,000	\$100,000	\$18,200	28%
\$100,000	\$150,000	\$23,800	30%
\$150,000	\$250,000	\$38,800	32%
\$250,000	\$500,000	\$70,800	34%
\$500,000	\$750,000	\$155,800	37%
\$750,000	\$1,000,000	\$248,300	39%
\$1,000,000	\$1,250,000	\$345,800	41%
\$1,250,000	\$1,500,000	\$448,300	43%
\$1,500,000	\$2,000,000	\$555,800	45%

Table 3. Unified Estate Tax Exclusion Amounts

Amounts Above	Year	Tax on Column A	Rate on Excess
\$1,000,000	2002–2003	\$345,800	50%, 49%
\$1,500,000	2004–2005	\$555,800	48%, 47%
\$2,000,000	2006–2008	\$780,800	46%, 45%, 45%
\$3,500,000	2009	\$780,800	45%
\$0	2010	\$0	
\$5,000,000	2011	\$1,750,000	35%
\$5,120,000	2012	\$1,792,000	35%
\$5,250,000	2013	\$2,100,000	40%
\$5,340,000	2014	\$2,136,000	40%
\$5,430,000	2015	\$2,172,000	40%
\$5,450,000	2016	\$2,180,000	40%
\$5,490,000	2017	\$2,196,000	40%

Table 4. Gift Tax Exclusion Amounts

<u>Year</u>	<u>Maximum Amount</u>
1982–2002	\$10,000
2003–2005	\$11,000
2006–2008	\$12,000
2009–2012	\$13,000
2013–2017	\$14,000

Gifts in excess of the annual exclusion limit are subject to taxes and are subtracted from your lifetime gift limit of \$5.49 million in 2017. The following are exempt from this limit: gifts less than the exclusion amount in any of the previous years; tuition payments made directly to the school or medical expenses paid directly to the hospital for others; and gifts to spouses, political organizations, or charities. While a gift for one year may be greater than the annual exclusion and requires you to file a gift tax return (Form 409), you may not have to pay a gift tax if you apply the unified credit to your gift tax.

Table 5. Gift Tax

<u>Year</u>	<u>Gift Tax Exemption Equivalent</u>	<u>Gift Tax Unified Credit</u>
2002–2010	\$1,000,000	\$345,800
2011	\$5,000,000	\$1,750,000
2012	\$5,120,000	\$1,792,000
2013	\$5,250,000	\$2,100,000
2014	\$5,340,000	\$2,136,000
2015	\$5,430,000	\$2,172,000
2016	\$5,450,000	\$2,180,000
2017	\$5,450,000	\$2,196,000

3. Unlimited marital deductions: There is no limit on the value of an estate that can be passed tax-free to a spouse who is a U.S. citizen. However, the unlimited marital deduction does not apply to spouses who are not U.S. citizens. The limit on tax-free gifts that can be made beyond the tax-free transfer threshold per year to non-citizen spouses is \$149,000 in 2017 (see Table 6).

Table 6. Tax-Free Gifts to Non-Citizen Spouses

<u>Year</u>	<u>Maximum Amount</u>
2013	\$143,000
2014	\$145,000
2015	\$147,000
2016	\$148,000
2017	\$149,000

4. Generation-skipping taxes (GSTT): In addition to the regular estate tax, a tax is imposed on any wealth or property transfers made to a person two or more generations younger than the donor. The GSTT is designed to allow tax-free transfers to spouses and children but imposes taxes on transfers going to grandchildren and others who are two or more generations away from the person making the transfer. The tax is 40 percent of the value of the property transferred in 2017 (see Table 7). There are exceptions to this tax. The \$14,000 gift-tax exclusion applies, as do the education-tax exclusion and medical-expense gift-tax exclusion. In addition, up to \$5.49 million per individual (\$10.98 million per couple) may be passed on to grandchildren in 2017 without incurring taxes.

Know How Trusts Can Be Used to Your Advantage in the Estate-Planning Process

Trusts give you professional management of your assets and provide for confidentiality. They may allow you to reduce your personal assets by transferring ownership to the trust, thus helping you avoid estate taxes. They may also allow you to avoid probate.

Table 7. Generation Skipping

Year	Generation-Skipping Transfer Tax Exemption	Tax Rate of Amount Over Exemption
2009	\$3,500,000	45%
2010	\$0	Repealed
2011	\$5,000,000	35%
2012	\$5,120,000	35%
2013	\$5,250,000	40%
2014	\$5,340,000	40%
2015	\$5,430,000	40%
2016	\$5,450,000	40%
2017	\$5,490,000	40%

Other benefits of trusts include that they may allow you to more clearly specify your desires regarding your assets, since they are much more difficult to challenge than wills. They may allow you to specify which assets should go to which children (particularly children from a previous marriage). Finally, trusts can be used to provide for children with special needs or to hold money until a child reaches maturity.

If any of the following conditions apply to you, you should seek professional advice regarding the ways a trust could benefit you:

1. Your total estate is larger than the estate tax-exemption amount, which was \$5.49 million in 2017.
2. You want to avoid probate.
3. You have specific desires or goals for the management and disbursement of your assets.
4. You want to leave an inheritance to children from a prior marriage.
5. You have a child with a handicap or a relative who requires specialized care because of a

disability.

Trust Assets

Once a trust is established, it is critical to transfer the assets to the trust; a trust is worthless until assets have been transferred into it. Trusts can hold all types of assets, including real property assets, such as a home; real estate assets; land tracts and out-of-state properties; liability and title insurance assets; property taxes; transfer taxes; and rental real estate.

Trusts can also hold credit cards, notes you owe, mortgages, loans, checking accounts, savings accounts, pay-on-death accounts, certificates of deposit, credit union accounts, safe deposit boxes, stocks, bonds, mutual funds, and savings bonds.

Trusts can hold real assets such as boats, automobiles, motorcycles, recreational vehicles, and other vehicles. In addition, they can hold life insurance and other self-provided insurance.

Businesses may be included in trusts if they are sole proprietorships, limited partnerships, closely held corporations, S corporations, limited liability companies, or general partnership interests.

Other assets that may be included in trusts include personal untitled property, copyrights, patents, royalties, oil and gas interests, club memberships, and foreign assets.

Types of Trusts

There are two different types of trusts: living trusts and testamentary trusts. A living trust is a trust in which assets are placed while you are still living. With a testamentary trust, assets are placed in the trust after you die. This trust is created after probate, according to your instructions.

1. Living trusts: There are two different types of living trusts: revocable living trusts and irrevocable living trusts.

A revocable living trust allows for unlimited control by the trust owner because the owner retains the title to all the assets in the trust. The advantage of a living trust is that the assets in the trust do not pass through probate when the owner dies. In addition, a living trust provides greater ease of distribution and greater privacy upon death. The disadvantage to a living trust is that it does not provide any tax advantages. The entire amount of the living trust is considered an asset for estate tax purposes.

An irrevocable living trust cannot be changed by the owner once established because the trust becomes a separate legal entity that owns all the assets it contains and pays taxes on the assets and the gains they produce. The advantage of an irrevocable living trust is that the assets are not subject to estate taxes, since they are not part of the owner's estate. Additionally, assets in the trust do not pass through probate. The disadvantage to an irrevocable living trust is that the owner no longer has the title to or use of any of the assets.

2. Testamentary trusts: A testamentary trust is a trust in which assets are placed only after the owner dies. The trust is created after probate, according to the desires of the owner, and the assets are transferred into the trust. There are different types of testamentary trusts, including standard family trusts, qualified terminable interest property trusts (Q-TIP trusts), and sprinkling trusts.

Standard family trusts hold the assets of the first spouse who dies until the second spouse dies. The surviving spouse has access to income from the trust, or the trust principal, if necessary. Standard family trusts reduce the size of the estate for the second spouse, which reduces estate tax liability.

A Q-TIP trust provides a means of passing on income to a surviving spouse without turning over control of the assets. These trusts ensure that assets will be passed on to your children upon the death of your surviving spouse.

A sprinkling trust distributes assets to a designated group of beneficiaries on an as-needed basis rather than in accordance with a preset plan.

Setting Up a Trust

In order to establish a trust, you must understand the following terminology:

Grantor: The person who creates the trust.

Trustee: The person who will manage the trust.

Successor trustee: The person who will succeed the trustee should the trustee be unable to manage the trust.

Beneficiaries: The recipients of the trust's earnings or assets.

Children's trusts: Trusts created for underage children.

Guardian: The person who raises children in lieu of their parents.

Children's trustee: The person who manages children's assets in lieu of their parents.

A qualified estate-planning lawyer or financial planner can help you establish a trust. Be sure to consult with a lawyer or financial planner who is not trying to sell you any products. Insist on seeing identification and a description of your consultant's qualifications, education, and expertise in estate planning. Seeking advice from a good, qualified consultant is important, especially if the size of the trust is significant and if there may be questions as to how assets should be distributed.

Do not allow yourself to be rushed. Ask for time to consider your decision, and report high-pressure tactics, misrepresentations, or fraud immediately to the Better Business Bureau. Always ask for a copy of any documents you sign, and know your cancellation rights. Finally, be wary of home solicitors who insist on receiving confidential and detailed information. If any concerns arise, call the Better Business Bureau and report the solicitors.

Be aware of the costs of establishing and managing a trust. The costs will vary from lawyer to lawyer, but they should include the costs of reviewing your assets and their present titles, discussing your estate plan, preparing your trust, and supervising the execution of the trust and the transfer of assets.

Understand the Importance of Wills and Probate Planning

A will is a legal document that indicates how the state should distribute your assets upon your death. The legal term for someone who dies without a will is “intestate.” When someone dies intestate, or without a will, the state determines, based on specific state laws, which assets will go to which individuals, regardless of the intentions of the deceased. That is why it is so critical to have a will.

Having a will ensures that state law will not dictate the distribution of your assets, the custody of your children, or the care of those under your responsibility who have special needs. A will also allows you to avoid the costs associated with having a court-appointed administrator.

The following are key terms related to wills that you should be familiar with:

Will: A legal document that transfers an estate after death.

Beneficiaries: People who receive the deceased’s property and assets.

Executor or personal representative: The person responsible for carrying out the provisions of the will.

Guardian: The person who cares for minor children of the deceased and manages the children’s property.

Wills

Wills can be handwritten, computer-generated, or oral. It is safest to have a will drawn up by a lawyer. Most wills (holographic wills being the exception) must be signed, witnessed by two or more people, and notarized.

Wills should be stored in a safe place; however, a safe-deposit box is not always a good place to store a will because it may be sealed upon your death. Always tell someone you trust where your will is so it can be found upon your death.

In order to have a valid will, a person must have mental competence and must not be under undue influence from another person. For a will to be valid, it must also conform to the laws of the state in which it is written.

An amendment to a will (a codicil) institutes minor changes to the original will. To be effective, a codicil must be signed, witnessed, and attached to the original will. However, if the changes are major, a new will should be drafted.

Probate

Probate is the process of distributing an estate's assets. The probate process includes appointing an executor if one is not named, validating the will, allowing for challenges to the will, overseeing the distribution of assets, filing a report with the court, and closing the estate.

There are numerous costs and fees involved in the probate process, including legal fees, executor fees, and court fees; these fees can be from one percent to eight percent of the estate's value. Additionally, the probate process can be quite slow, especially if there are challenges to the will or tax problems.

Ways to Avoid Probate

You can avoid probate in the following ways:

Have joint ownership: There are several different options for joint ownership of property that help you avoid probate. You can have tenancy by the entirety, joint tenancy with the right of survivorship, tenancy in common (where the will controls distribution of the deceased's share of the property), or community property (where state law and a will control distribution of the property). Each of these methods does not require probate for the transfer of titled property.

Make gifts (with the exception of life insurance policies): You can take advantage of unlimited gift-tax exclusions on payments made for medical and educational expenses. However, you must make the payments directly to the hospital or college. Money donated to charities is also eligible for gift-tax exclusions.

Name beneficiaries in contracts such as life insurance: In most cases, ownership of contracts such as life insurance passes to the beneficiaries upon death of the owner without the contract having to be probated.

Use trusts: Two types of trusts allow you to avoid probate: a living trust, which takes effect before death, and a testamentary trust, which takes effect upon death.

Other Estate-Planning Documents

There are a number of estate-planning documents you should be aware of:

Durable power of attorney: This document allows someone to act on your behalf if you should become mentally or physically incapacitated. This document is separate from the will and goes into effect before your death. A durable power of attorney should be very specific as to which legal powers it transfers.

Living will: A living will is a document that states your wishes regarding medical treatment in the event of a terminal illness or injury.

Health-care proxy: A health-care proxy designates someone to make health-care decisions for you if you should become unable to make them yourself.

Summary

Estate planning is the process of planning for the accumulation, conservation, and distribution of estate assets; this process can help you accomplish your personal and family goals. Every estate is planned, either by the individual or by default through rules established by the state and local governments. The purpose of estate planning is to ensure that you—and not others, such as the government or lawyers—choose who will inherit your wealth.

There are four steps in the estate-planning process: (1) determine how much your estate is worth, (2) choose your heirs and decide on the assets they will receive, (3) determine the cash needs of the estate and calculate your estate taxes, and (4) select and implement estate-planning techniques to maximize goals and minimize taxes. Estate planning can help you use your assets wisely in order to achieve your personal goals even after you die. The four key taxes on estates are estate taxes, gift taxes, unlimited marital deductions, and generation-skipping taxes.

When you create a trust, you enter into a legal contract that gives you professional management of your assets and provides for confidentiality. Trusts may allow you to reduce your personal assets by transferring ownership to the trust, thus helping you avoid estate taxes. They may also allow you to avoid probate. Other benefits include that they may allow you to more clearly specify your desires regarding your assets, since trusts are much more difficult to challenge than wills. They may allow you to specify which assets should go to specific children (particularly children from a previous marriage). Finally, trusts can be used to provide for children with special needs or to hold money until a child reaches maturity.

A will is a legal document that indicates the way the state should distribute your assets upon your death. Someone who dies without a will is “intestate.” When someone dies intestate, the state determines, based on specific state laws, which assets will go to which individuals, regardless of the intentions of the deceased. Having a will ensures the state law will not dictate the distribution of your assets, the custody of your children, or the care for those under your responsibility with special needs. A will also allow you to avoid having a court-appointed administrator and the associated costs.

Assignments

Financial Plan Assignments

First, review the goals you made in Chapter 2. Do you have specific goals that may extend beyond your lifetime and would require a trust? If so, what would you like to do about these goals? Are they feasible given your current financial condition? Review your net worth (discussed in Chapter 3). Does your current net worth exceed the estate tax threshold established by the IRS? How close are you to the threshold? If you are close, you should get qualified help.

Second, do you have a will? If you have children, a will is critical because it states your wishes regarding who should take care of your children should you pass away. Your choice is either to write your own will or let the government determine how you would have wanted your assets distributed. If you have few assets and you reside in a state that allows holographic wills, write one immediately. At least write your wishes regarding who is to take care of your children. If you are beginning to acquire assets, it is recommended that you visit a legal attorney who can, for a fee, help you write up a will that is valid for your state. Wills should be reviewed every three to five years, or more often if your situation changes.

Finally, are you concerned that your wishes regarding health-care might not be made known to medical personnel should something happen to you and you are unable to communicate your wishes? Filling out Learning Tool 14: Sample Advance Directives to Physicians will allow you to state your intentions for medical care in the event of an emergency in which you are unable to make your wishes known.

Review Materials

Terminology Review

Advanced Health Care Directive. This document, also known as a living will or personal or advance directive, is a legal document where a person specifies what actions should be taken for their health care if they are no longer able to make decisions for themselves due to illness or other reasons.

Beneficiaries. The people who receive the property or assets.

Children's Trustee. The person who manages the assets for the children.

Children's Trusts. Trusts specifically for underage children.

Codicil. A document which institutes minor changes in the original will. Must be signed, witnessed, and attached to the original will.

Community Property. A form of ownership is equal and only between partners. Lifetime control is shared by both spouses, consent from both is required to sell, income is shared between owners, and testamentary control in the one-half interest is unlimited unless property has right of survivorship feature (applicable in some states).

Durable power of attorney. This provides for someone to act on your behalf in the event you should become mentally or physically incapacitated. This document is separate from the will and goes into effect before death. This document should be very specific as to which legal powers it transfers.

Estate planning. The process of anticipating and arranging for the disposal of your

resources to accomplish your personal and family goals after you pass away.

Estate Taxes. These are taxes, paid to the government, due on passing of an individual. Estate taxes are equal to the gift-adjusted taxable estate multiplied by the appropriate tax rate. To determine the net tax owed, calculate the total tax owed and subtract the unified gift and estate tax credit.

Estate transfer. This is the process that property interests are legally transferred from one to another, either during the person's lifetime or at death

Exclusion Amount. This is the amount of estate value that is excluded from the estate tax.

Executor or personal representative. This is the person who is responsible for carrying out the provisions of the will.

Generation-Skipping Tax. This is a tax on revenue lost when wealth is not transferred to the next generation, but to a succeeding generation. It is a flat tax, in addition to the regular estate tax, imposed on any wealth or property transfers to a person two or more generations younger than the donor.

Gift Tax Exclusions. A gift tax must be paid on all transfers to others (other than a spouse) that are in excess of the maximums specified. The maximum specified is your exclusion.

Gift-Adjusted Taxable Estate. This is equal to your taxable estate plus any taxable lifetime gifts, which is the cumulative total of all gifts over the annual limit.

Gross Estate. This is the value of all your assets, including life insurance, pensions, investments, and any real or personal property.

Guardian. The person who cares for minor children and manages their property.

Health care proxy. A health care proxy designates someone to make health care decisions should you be unable to do so for yourself.

Holographic Will. A will and testament that is entirely handwritten and signed by the testator. Traditional wills require signatures of witnesses as well as the testator's signature and intent. Holographic wills are treated equally with witnessed will and need only to meet minimal requirements in order to be probated

Intestate. The process whereby the state essentially writes the will for a person because they did not prepare a will during their lifetime.

Irrevocable Living Trust. A trust that cannot be changed by the owner once established,

because the trust becomes another legal entity which owns all the assets contained in the trust and pays taxes on the assets and gains they produce. The assets are not subject to estate taxes since they are not part of your estate and assets in the trust do not pass through probate.

Issue. These are children.

Joint Tenancy with Right of Survivorship (JTWROS). Ownership is shared equally and lifetime control is shared, income is shared between owners, testamentary control is absent, and then right of survivorship is key.

Lifetime transfers. Methods of transferring property including the sale or gifting of one asset to another.

Living Trust. A trust where assets are placed in the trust while you are still living. You can take them out and move them according to what you want to do before you die.

Living will. It is a legal document that details your end-of-life wishes for health care. It is used when you are still alive but unable to make health care decisions for yourself. A living will states your wishes regarding medical treatment in the event of a terminal illness or injury

Non-probate transfers. These are “will substitutes,” and include state law, right of survivorship, beneficiary designations, and gifts causa mortis.

Personal Representative (Executor). This is the person who fulfills the requirements of the trust or will.

Probate. Probate is the process of distributing an estate's assets after death. Probate is a matter of state law. It is the matter of administering the portion of the person's estate that is disposed of in either by will provisions, for those with a valid will, or by intestate succession, for those who die without a will.

Q-TIP (Qualified Terminable Interest Property) Trust. A Q-TIP Trust is a testamentary trust which provides a means of passing income to the surviving spouse without turning over control of the assets. These trusts ensure that assets will be passed to your children upon the death of the surviving spouse.

Revocable Living Trust. It is the most common type of living trust. It is a trust which allows for unlimited control by the trust's owner, because the owner retains title to all the assets in the trust. They do not pass through probate. They provide greater ease and privacy of distribution upon death.

Sole ownership. Ownership where ownership and control is absolute in one individual. Income belongs to sole owner and testamentary control is absolute.

Sprinkling Trust. A Sprinkling Trust is a testamentary trust that distributes assets on a needs basis rather than according to some preset plan to a designated group of beneficiaries.

Standard Family trust. This is a testamentary trusts which hold the assets of the first spouse to die until the second spouse dies. The spouse has access to income from the trust, or the trust principal, if necessary. They reduce the estate of the second spouse so that the estate taxes can be reduced.

Stepped Up Basis. This is the process of the value of an asset being stepped up, or changed from the original value when purchased, to the current value when the person dies and it is transferred to heirs.

Successor Trustee. This is the person to succeed the trustee should the trustee not be able to manage the trust.

Taxable Estate. This is equal to the gross value of your estate, less estimated funeral and administrative expenses, debts, liabilities, taxes and any marital or charitable deductions.

Tenancy by the entirety. Ownership is shared equally and limited to spouses, lifetime control is shared by both spouses, consent from both is required to sell, income is shared between owners, testamentary control is absent, and the right of survivorship is key.

Tenancy in Common. Ownership is shared, with each owning an undivided fractional interest that may be unequal, lifetime control is unlimited, income is shared between owners in relation to fractional interest, and testamentary control is unlimited.

Testamentary transfers. Methods by which property is transferred at death.

Testamentary Trust. The process where assets are placed in trust after you die. The trust is created after probate according to your will.

Trust Grantor. The person who created the trust.

Trustee. The person who will manage the trust.

Trusts. A trust is a legal contract. When you create a trust you are simply creating another legal entity. Trusts avoid probate and are more difficult to challenge than wills. They may reduce estate taxes, allow for professional management, provide for confidentiality, can be used to provide for children with special needs, can be used to hold money until a child reaches maturity, and can assure that children from a previous marriage will receive some inheritance in the future.

Unlimited Marital Deduction. There is no limit on the value of an estate that can be passed tax-free to a U.S. citizen spouse. This does not apply to non-U.S. citizen spouses.

The tax-free maximum gift per year to non-citizen spouses is specified.

Will. A legal declaration by which a person provides for the disposition for their property and other assets at death.

Review Questions

1. What is estate planning?
2. What are the five main goals of estate planning?
3. What are four ways to designate where property should go after you die?
4. What are the four steps of the estate-planning process?
5. What are the four taxes that may be imposed on an estate?

Case Studies

Case Study 1

Data

Jonathan, a single man, passed away in December 2017. The value of his assets at the time of his death was \$6,155,000. He also owned an insurance policy with a face value of \$315,000 (which was not in an irrevocable trust). The cost of his funeral was \$19,750, and estate administrative costs totaled \$67,000. As stipulated in his will, he left \$154,000 to charities. Also, for each of the years 2007 to 2009, Jonathan provided his niece Suzy with \$20,000 per year for college tuition. Of this \$20,000, \$5,000 was paid directly to the college for tuition and fees, and the remaining \$13,000 was paid to his niece to cover her living expenses while she was going to school, and \$2,000 was for clothes. In addition to paying for his niece's schooling, he also gave her \$25,000 as a late graduation present in 2010 for a down payment on a new house.

Calculations

Determine the value of Jonathan's gross estate, his taxable estate, his gift-adjusted taxable estate, and his year 2017 estate tax. The annual tax-free gift limits are as follows: 2013-2017: \$14,000; 2012-2009: \$13,000; 2008-2006: \$12,000.

Case Study 1 Answers

What is the gross value of Jonathan's estate?

Gross Estate = assets + life insurance policies not in irrevocable trusts

Gross Estate = \$6,155,000 + \$315,000 = \$6,470,000

Determine the value of his taxable estate?

Taxable Estate = Gross Estate – liabilities – funeral expenses – administrative expenses – charitable deductions

Taxable Estate = \$6,470,000 – \$19,750 – \$67,000 – \$154,000 = \$6,229,250

Determine his gift-adjusted taxable estate

Gift-Adjusted Taxable Estate = Taxable estate + gifts in excess of the annual allowance

$$\text{Gift-Adjusted Taxable Estate} = \$6,229,250 + \$8,000 + \$12,000 = \$6,249,250$$

Of the \$20,000 each year, \$5,000 was paid directly to the school, so the \$5,000 is not counted in the tax-free gift. Only the payments of \$15,000 are counted. After the limits are reached of \$12,000 in 2007 and 2008, and 13,000 in 2009, there is an excess of \$8,000. Of the \$25,000 in 2010, \$13,000 was the tax-free exclusion, resulting in \$12,000 to be added in excess of the allowance. Total to add back is \$20,000.

Determine his estate tax liability for 2017 on gift-adjusted tax of \$6,249,250.

Amount Above	Year	Tax on Column A	Rate on Excess
\$5,490,000	2017	\$2,196,000	40%

Two ways to calculate the tax

$$\text{a. } (\$6,249,250 - \$5,450,000) * 40\% = \$303,700$$

$$\text{b. } (\$6,249,250 * 40\%) - \$2,196,000 = 303,700$$

The unified credit amount in 2017 is \$2,196,000.

The estate tax is the difference between tax owed and the unified credit

Case Study 2

Data

The value of Suzy's estate plus taxable gifts is \$6.7 million at the time of his death in 2017.

Calculations:

A. What is her estate tax liability?

B. How would the estate tax liability change if \$1.3 million of his estate was held in an irrevocable trust?

Case Study 2 Answers

A. Calculating federal estate tax requires calculating Suzy's estate tax and then subtracting his unified credit. On an estate of \$6.7 million, the amount in 2017 would be:

Amount Above	Year	Tax on Column A	Rate on Excess
\$5,490,000	2017	\$2,196,000	40%

$$(\$6,700,000 - \$5,490,000) * 40\% = \$484,000$$

$$(\$6,700,000 * 40\%) - \$2,196,000 = \$484,000$$

The unified credit amount in 2017 is \$2,196,000.

The tax is the difference between tax owed and the unified credit: \$484,000

B. Assuming that \$1.3 million is held in an irrevocable trust, the taxable estate drops to \$5.4 million, which is less than the exemption equivalent of \$5.49 million in 2017, so estate taxes would be \$0.

Case Study 3

Data

In 2017, Dave and Sally gave \$32,000 to their son for a down payment on a house.

Calculations:

- A. How much gift tax will Dave and Sally owe?
- B. How much income tax will their son owe?
- C. List three advantages of making this gift.
- D. How could they have avoided the gift tax?

Case Study 3 Answers

- A. There will be a gift tax in 2017 as the amount is \$4,000 in excess of the \$28,000 maximum transferable each year (\$14,000 per individual in 2017). They will need to fill out a gift-tax form. The gift tax before exclusions will be $\$4,000 * .18 = \720 .
- B. Their son will not have to pay any income tax because recipients of a gift do not have to pay tax on the gift. Recipients do have to pay tax on future income generated by the gift but not directly on the gift.
- C. Advantages include (1) providing needed income to a family member, (2) reducing the donor's estate taxes (the recipient is not taxed), and (3) helping avoid probate as gifted assets no longer belong to the donor.
- D. They could have eliminated this need for a gift tax by splitting the gift over two years. One idea would be to give their son \$28,000 in cash in 2017, and give him a loan for \$4,000 for the remainder. Then in 2017, they gift him another \$4,000 to repay the loan.

Case Study 4

Data

Anne Smith had a \$5,500,000 net worth at the time of her death in 2016. In addition, she had a \$250,000 whole life policy with \$40,000 of accumulated cash value; her niece was the beneficiary. She also had a \$150,000 pension plan benefit.

Calculations

- A. What was the gross value of Anne's estate?
- B. How much of her estate is taxable?
- C. How much estate tax will need to be paid?
- D. How much of her estate must pass through probate?

Case Study 4 Answers

- A. Anne's estate is calculated by adding to her net worth (estate taxes minus debts) the value of her life insurance death benefit plus death benefits associated with her employer retirement plan. Note that cash value is not distributed (unless with an insurance rider).
 $\$5,500,000 + 250,000 + 150,000 = \$5,900,000$
- B. All of Anne's \$5,900,000 estate is taxable.
- C. Anne will need to pay $(\$5,900,000 - 5,490,000) * 40\% = \$164,000$ in estate taxes
- D. Any of the \$5,500,000 that passes to the heirs must go through probate.

Case Study 5

Data

Suzanne and Steve Smith have \$2.2 million of assets in 2017: \$600,000 in Steve's name, \$600,000 in Suzanne's, and \$1,000,000 of jointly owned property. Their jointly owned property is titled using joint-tenancy with right of survivorship. Suzanne also co-owns a \$400,000 beach house with her sister Emily as tenants-in-common.

Application

- A. What is the maximum amount of estate value that can be transferred by the Smiths free of estate tax in 2017?
- B. What do the Smiths need to do to reduce their expected tax liability?
- C. Who would receive Suzanne's half-share in the beach house if she were to die?

Case Study 5 Answers

- A. The Smiths could jointly transfer a total of \$10,980,000 before incurring federal estate tax in 2017.
- B. The Smiths should re-title their ownership of the property and put it in a trust to take advantage of taxes. In this way they can take advantage of a standard family trust and gift-giving.
- C. Suzanne's half-share of the beach house would go to whomever she names in her will. If she dies intestate, state law will determine how her share in the beach house is transferred.

¹ "Preparing for Emergencies," *Ensign*, Dec. 1990, 59