Financial Services, LLC

Introduction to Estate Planning

What is estate planning?

Simply stated, estate planning is a method for determining how to distribute your property during your life and at your death. It is the process of developing and implementing a master plan that facilitates the distribution of your property after your death and according to your goals and objectives.

At your death, you leave behind the people that you love and all your worldly goods. Without advance planning, you have no say about who gets what, and more of your property may go to others, like the federal government, instead of your loved ones. If you care about (1) how and to whom your property is distributed, and (2) ensuring that your property is preserved for your loved ones, you need to know more about estate planning.

As a process, estate planning requires a little effort on your part. First, you'll want to come to terms with dying, at least to a degree that you can deal with the necessary planning. Understandably, your death can be a very uncomfortable subject, but unfortunately, the discussions in this area are full of references to your death, so it really can't be avoided. Some statements may seem too businesslike and unfeeling, but tiptoeing around the subject of dying will only make the planning process more difficult. You will understand the process more easily and implement a more successful master plan if you approach it in a straightforward manner.

Who needs estate planning?

Not just for the wealthy

Estate planning may be important to individuals with a wide range of financial situations. In fact, it may be more important if you have a smaller estate because the final expenses will have a much greater impact on your estate. Wasting even a single asset may cause your loved ones to suffer from a lack of financial resources.

Your master plan can consist of strategies that are simple and inexpensive to implement (e.g., a will or life insurance). If your estate is larger, the estate planning process can be more complex and expensive.

Implementing most strategies will probably require you to hire professional help of some kind, an attorney, an accountant, a trust officer, or an insurance agent, for example. If your estate is large or complex, you should consult with an estate planning expert such as a tax attorney or financial planner for advice before the implementation stage.

In deciding on your course of action, you should always consider whether the benefit of the strategy outweighs the cost of its implementation.

May be especially needed under certain circumstances

You may need to plan your estate especially if:

- Your estate is valued at more than the estate tax applicable exclusion amount(formerly known as the unified credit), which equals $3.5 million for deaths occurring in 2009 (but see tip below)
- Your income tax bracket is in excess of 10 percent
- You have children who are minors or who have special needs
- Your spouse is uncomfortable with or incapable of handling financial matters
- You're a business owner
- You have property in more than one state
- You intend to contribute to charity
- You have special property, such as artwork or collectibles
- You have strong feelings about health-care decisions
- You have privacy concerns or want to avoid probate

Tip: In 2010, the estate tax is scheduled to disappear completely. Then, unless Congress passes an extension, the exemption will revert back to $1 million in 2011. So, estates over $1 million may actually want to make appropriate plans to be on the safe side.

How to do it

Designing a plan is a process that is unique to each estate owner. Don't be intimidated or overwhelmed at the prospect. Even the most complex plan can be achieved if you proceed step by step. Remember, the peace of mind that comes with developing a successful estate plan is worth the time, trouble, and expense.

Understand your particular circumstances

Begin the estate planning process by understanding your particular circumstances, such as your age, health, wealth, etc.

Understand the factors that will affect your estate

You will also need to have some understanding of the factors that may affect the distribution of your estate, such as taxes, probate, liquidity, and incapacity.

Clarify your goals and objectives

When your particular circumstances and the factors that may affect your estate are clear, your goals and objectives should come into focus.

Understand the strategies that are available

With these goals and objectives now clear, you can begin to consider the different estate planning strategies that are available to you.

Seek professional help

Seeking professional help (an attorney or financial advisor) will help you understand the strategies that are available and formulate and implement your master plan.

Formulate and implement a plan

Finally, after following these steps, you can formulate and implement a plan that works for you. Here are a few basic tips: (1) make sure you understand your plan, (2) rely on people you trust, and (3) keep your documents and information organized and within easy reach.

Perform periodic reviews

When you have implemented your master plan, be sure to perform a periodic review and, if necessary, make revisions that reflect any changing circumstances and tax laws. For more information, see Reviewing Your Estate Plan.

How do you begin?

There are many estate planning strategies, including some that are implemented inter vivos (during life), such as making gifts, and others post-mortem (after death), such as disclaimers. Before you choose which strategies are right for you, you need to understand your particular circumstances.

Gather and analyze the facts

Understanding your particular circumstances results from gathering and analyzing the facts. The following questions may help you to accomplish this. If they are not easy to answer, you may have to make some estimates based on reasonable assumptions and expectations.
Information regarding your financial condition

- What is your current income?
- What is your income likely to be in the future?
- How much do you spend each year?
- What are your expenses likely to be in the future?
- What are your current assets and debts?
- Are your assets currently owned solelyor jointly?
- What estate planning strategies have you already implemented?

Family information

- Who are the family members you intend to benefit?
- What are the needs of each family member?

What other factors need to be considered?

Decide what your goals and objectives are in light of your particular circumstances and in light of the factors that may affect your estate. The primary factors that may affect your estate are your beneficiaries, taxes, probate, liquidity, and incapacity.

Taxes

One of the largest potential expenses your estate may have to pay is taxes, which may include federal transfer taxes, state death taxes, and federal income taxes.

Federal transfer taxes--The federal transfer taxes include (1) the federal gift tax and federal estate tax and (2) the federal generation-skipping transfer tax (GSTT).

- Federal gift tax--Gift tax is imposed on property you transfer to others while you are living. You need a basic understanding of how the gift tax system works to minimize gift tax liability. Under the gift tax system, you are allowed a $1 million lifetime gift tax applicable exclusion amount that reduces your gift tax liability (any gift tax applicable exclusion amount you use during life effectively reduces the applicable exclusion amount that will be available at your death). Also, you are allowed to give $13,000 (2009 figure) per donee gift tax free under the annual gift tax exclusion. Further, certain other types of transfers can be made gift tax free. You need to understand what these types of transfer are and how they work to take full advantage of them.

- Federal estate tax--Generally speaking, estate tax is imposed on property you transfer to others at the time of your death. You need a basic understanding of how the estate tax system works for several reasons:
    - Saving your property for your beneficiaries--Estate tax rates reach as high as 45 percent in 2009, which means that an enormous chunk of your estate may go to the federal government instead of your beneficiaries. If you want to preserve your estate for your beneficiaries, you'll need to know how to minimize estate tax with respect to your property.
    - Reducing estate tax liability--Under the estate tax system, you are allowed an applicable exclusion amount(formerly referred to as the unified credit) that reduces your estate tax liability. Also, there are exclusions, deductions, and other credits available that allow you to pass a certain amount of your estate tax free. You need to understand what these exclusions, deductions, and credits are and how they work to take full advantage of them.
    - Providing for the payment of estate tax--Generally, estate tax must be paid within nine months after your death. To avoid depriving your beneficiaries of what you intend for them to receive, you should provide that specific and sufficient assets be set aside and used for this purpose. In addition, these assets should be sufficiently liquid to pay these expenses when they are due.
    - Planning for estate tax expense--Although calculating estate tax can be complex, you should estimate what the amount of your estate tax may be (if any), so that you can arrange to replace that wealth.
- GSTT--Another federal transfer you need to understand is the federal generation-skipping transfer tax (GSTT). The GSTT is imposed on property you transfer to an individual who is two or more generations below you (e.g., a grandchild or great-nephew). Not surprisingly, the IRS wants to levy a tax on property as it is passed from generation to generation at each and every level. The purpose of the GSTT is to keep individuals from avoiding estate tax by skipping an intermediate generation. A flat tax rate equal to the highest estate tax then in effect is imposed on every generation-skipping transfer you make over a certain amount ($3.5 million in 2009). Currently, some states also impose their own GSTT. Check with an attorney or your state to find out what may be subject to your state's GSTT, and how and when to file a state GSTT return.

State death taxes--States also impose their own death taxes. You should be aware of what the death tax laws are in your state and how they may affect your estate. There are three types of state death taxes: (1) estate tax, (2) inheritance tax, and (3) credit estate tax (also called a sponge tax or pickup tax). Some states also impose their own gift tax and/or generation skipping transfer tax.

- Estate tax--State estate tax is imposed on property you transfer to others at your death, much like federal estate tax. The state estate tax calculation for most states is similar to the federal calculation.
- Inheritance tax--Unlike estate tax, the inheritance tax is imposed on your beneficiary's right to receive your property. Tax is due on each beneficiary's share of your estate. Beneficiaries are grouped into classes (generally based

upon their familial relationship to you) and are taxed accordingly. Although inheritance tax is due on each heir's share of your estate, it's your personal representative who writes the check from your estate to pay it.

- Credit estate tax--Some states impose a credit estate tax (also referred to as a sponge tax or pickup tax).

Tip: Most states that imposed a credit estate tax have "decoupled" from the federal system (i.e., they're imposing some form of stand-alone estate tax.)

Tip: The federal system allows a deduction for state death taxes for the estates of persons dying in 2005 through 2009. Prior to 2005, a credit was available, which will be reinstated in 2011.

Federal income taxes--In the estate planning context, you should be aware of three federal income tax considerations:

1. Income taxation of trusts--If your estate plan includes the use of a trust, you need to know that a trust may be an income tax-paying entity. The trustee may be required to file an annual return and pay income taxes on trust income.
2. Decedent's final income tax return--Your personal representative or surviving spouse has the duty of filing your last income tax return that covers the tax year ending on the date of your death.
3. Income taxation of your estate--Your estate is considered a separate income taxpaying entity. Your personal representative must file and pay income taxes on any income your estate receives (e.g., interest from bonds, or dividends from stock).

Probate

Probate is the court-supervised process of proving, allowing, and administering your will. The probate process can be time-consuming, expensive, and open to public scrutiny. Avoiding probate may be one of your most important goals. To develop a successful avoidance strategy, you'll need to understand how the probate process works, how to estimate probate costs, and what is subject to probate.

Liquidity

Estate liquidity refers to the ability of your estate to pay taxes and other costs that arise after your death from cash and cash alternatives. If your property is mostly nonliquid (e.g., real estate, business interests), your estate may be forced to sell assets to meet its obligations as they become due. This could result in an economic loss, or your family selling assets that you intended for them to keep. Therefore, planning for estate liquidity should be one of your most important estate planning objectives.

Incapacity

Planning for incapacity is a vital yet often overlooked aspect of estate planning. Who will manage your property and make health-care decisions for you when you can no longer handle these responsibilities? You need to ask and answer this question because the consequences of being unprepared may have a devastating effect on your estate and loved ones. You should include plans for incapacity as a part of your overall estate plan.

What are your goals and objectives?

Your goals and objectives are personal, but you can't formulate a successful plan without a clear and precise understanding of what they are. They can be based on your particular circumstances and the factors that may affect your estate, as discussed earlier, but your feelings and desires are just as important. The following are some goals and objectives you might consider:

- Provide financial security for your family
- Ensure that your property is preserved and passed on to your beneficiaries
- Avoid disputes among family members, business owners, or with third parties (such as the IRS)
- Provide for your children's or grandchildren's education
- Provide for your favorite charity
- Maintain control over or ensure the competent management of your property in case of incapacity
- Minimize estate taxes and other costs
- Avoid probate
- Provide adequate liquidityfor the settlement of your estate
- Transfer ownership of your businessto your beneficiaries

What are estate planning strategies?

An estate planning strategy is any method that facilitates the distribution of your assets and the settlement of your estate according to your wishes. There are several estate planning strategies available to you.

Intestate succession

Intestate succession is a strategy by default and is a means of transferring your property to your heirs if you have failed to make other plans such as a will or trust. State law controls how and to whom your property is distributed, who administers your estate, and who takes care of your minor children. Without directions, your opinions and feelings are not considered. Indeed, one of your primary goals in planning your estate may be to avoid intestate succession.

Last will and testament

A will is a legal document that lets you state how you want your property distributed after you die, who shall administer your estate, and who will care for your minor children. This is probably the most important tool available to you. Anyone with property or minor children should have a will.

Will substitutes

A will substitute, for example, Totten Trust and payable on death bank accounts, allows you to designate a beneficiary of certain property that will automatically pass to that beneficiary after you die and avoids passing through probate.

Trusts

A trust is a separate legal entity that holds your assets that are then used for the benefit of one or more people (e.g., you, your spouse, or your children). There are different types of trusts, each serving a different purpose, and include marital trusts and charitable trusts. You will need an attorney to create a trust.

Joint ownership

Joint ownership is holding property in concert with one or more persons or entities. There are different types of joint ownership, such as tenancy in common and community property, each with different legal definitions, requirements, and consequences.

Life insurance

Life insurance is a contract under which proceeds are paid to a designated beneficiary at your death. Life insurance plays a part in most estate plans.

Gifts

A gift is a transfer of property, not a bona fide sale, that you make during your life to family, friends, or charity. Making gifts can be personally gratifying as well as an effective estate planning tool.

Tax exclusions, deductions, and credits

There are several important estate planning tools you can use that are offered by the federal government. These include the annual gift tax exclusion, the applicable exclusion amount, the unlimited marital deduction, split gifts, and the charitable deduction..