The ABC's of Estate Planning

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What Will We Cover?

- Planning for Disability
- Commonly Asked Questions Regarding Probate
- Ownership of Assets
- Estate Planning Documents
- Estate and Gift Taxes

What is Estate Planning All About?

Process by which a person creates a structure for the management and distribution of wealth during lifetime and after death in the manner which carries out his/her wishes.

Lifetime Planning v. Death Planning

Planning for Disability

1) No planning – Court proceeding must be opened by family. Court appoints Guardian to protect interest of disabled person.

Disadvantages

- Expensive
- Time Consuming
- Lack of Control
- Court determines disability

Lifetime Planning v. Death Planning (cont.)

2) Other Alternatives

- Durable Powers of Attorney
  - Statutory
  - Some control
  - Limited applicability
- Revocable Living Trust

Planning for Death

<u>Why do I Need a Will?</u>

- Without a Will, state law prevails.
- You cannot choose who gets your assets.
- You cannot determine when they get your assets.
- You cannot determine who administers your estate.
- The person administering your estate will be required to have a surety (insurance company) and incur expense of a bond.

Planning for Death (cont.)

<u>What is Probate?</u>

- State court proceeding whereby decedent's assets are collected and used to pay debts, administration expenses and taxes, and balance paid to heirs (no will) or legatees (pursuant to will).
- Applies to estates where decedent owns <u>any</u> real estate or personal property in his/her own name in excess of $100,000 (Illinois).
- Not all assets are subject to probate.
- Applies whether or not you have a will.
- Additional probate may be required if you own real estate in another state .

Planning for Death (cont.)

Why Avoid Probate?

- Time consuming – 6 months – 3+ years.
- Legal fees – 3% - 10% on average.
- Court costs.
- Requirement for Surety on Administrator's Bond.
- Court supervises all actions of Executor or Administrator (Supervised Administration).

Planning for Death (cont.)

How Do You Avoid Probate?

- Keep individually owned assets under $100,000.
- Maintain assets in alternative forms of ownership.
  - Joint tenancy
  - Payable on death accounts
  - Land trusts
  - Life Insurance
- Execute and fully fund a Revocable Living Trust.

Forms of Ownership

Sole Ownership

- Total control while alive and competent.
- Guardianship proceedings in case of disability.
- Probate in the event of death.
- Distribution determined by Will.

Forms of Ownership (cont.)

Co-Ownership

1) Joint Tenancy (A or B)

- Avoids Probate.
- Title passes automatically and <u>outright</u> at death.
- Some loss of control.
- Court proceeding required in case of incapacity of either owner.
- Joint tenancy trumps distribution by will or trust.
- Tenancy by Entirety – special form of Joint Tenancy.

Forms of Ownership (cont.)

2) POD or TOD Accounts (A, payable in death to B).

- Avoids probate at death.
- Retain control during lifetime.
- Title passes automatically and <u>outright</u> at death.
- Court proceeding required in case of incapacity of life owner.
- Title on account trumps distribution by will or trust.

Forms of Ownership (cont.)

3) Beneficiary Designation (Life Insurance, 401(k), Profit Sharing and IRA

- Avoids probate at death.
- Participant retains control during life.
- Proceeds pass to beneficiary in manner set forth in designation form.
- Beneficiary designation should be coordinated with estate plan.
- Unique income tax features.

Forms of Ownership (cont.)

4) Funded Revocable Living Trust.

- Avoids probate – ***if funded***.
- Avoids guardianship proceeding in case of incapacity.

Estate Planning Documents

1) Will

- Controls assets in decedents name alone.
- Provides for who gets assets and when.
- States who controls the process (Executor).
- Names guardian for minor children in case of death of both parents.
- Waives need for surety on executor's bond.

Estate Planning Documents (cont.)

<u>Simple Will</u>

- Everything to named beneficiaries, outright .
- Normally appropriate in smaller estates – where no minor children.

Estate Planning Documents (cont.)

Will with Contingent Trusts

- Everything to spouse but upon both deaths, trust held for under-age beneficiaries .
- Protects children's inheritance against creditors or bad marriage.
- Appropriate for individual with minimum assets or no desire to avoid probate, and young children or children with financial or marital problems.

Estate Planning Documents (cont.)

Pour-Over Will

- Used in conjunction with Living Trust.
- Provides that all assets in individual's name added ("pours over") to trust at death.

Estate Planning Documents (cont.)

2) Revocable Living Trust

- **Definition:** Vehicle created by an Individual (Grantor) during lifetime for benefit of Grantor during life and others after death.

Estate Planning Documents (cont.)

Characteristics of Living Trust

- Provides that grantor can amend or revoke trust at any time during life.
- Grantor receives benefits and retains total control during lifetime.
- Provides mechanism for determining incapacity (e.g. certification by spouse and physician).
- Trust assets held for grantor's benefit during incapacity.
- Grantor controls disposition of assets at death.
- Can be used to minimize estate taxes.
- No asset protection for Grantor, but can be for beneficiaries.

Estate Planning Documents (cont.)

How does Living Trust operate?

- Grantor can be initial trustee and beneficiary.
- All individually owned assets should be transferred into Grantor's name "as trustee of living trust of _____________ under trust dated ______________."
- Life insurance proceeds owned by grantor should be payable to trust.
- Trust often named as beneficiary or contingent beneficiary of IRA, 401(k) Plan and profit sharing account.
- After death, assets held for individual beneficiaries.

Estate Planning Documents (cont.)

3) Irrevocable Life Insurance Trust

- Primary advantage is that it is a vehicle for the transfer of ownership of life insurance policies out of insured's estate at very low lifetime value.
  - Term Insurance – no value.
  - Whole Life – low cash surrender value.

Irrevocable Life Insurance Trusts (cont.)

Estate Tax Treatment

Proceeds not taxable in insured's estate if insured has no "incidents of ownership" over policy.

- No right to name beneficiary.
- No right to value of policy.
- No right to be trustee.
- No right to a reversion.

Estate Planning Documents (cont.)

4) Durable Power of Attorney – Property

- Provides that a person ("agent") can make financial decisions for the benefit of the principal.
- Principal must be competent when executing but power is effective during incapacity.
- Powers relate to assets outside of trust.
- Can be effective immediately or at some future time.
- Short form statutory power of attorney normally used – new form as of July 1, 2011.

Estate Planning Documents (cont.)

5) Power of Attorney – Health Care

- Allows agent to make health care decisions for principal.
  - Admittance to hospital or institution.
  - Administration of medication.
  - Surgery or other procedures.
  - Anatomical gifts.

Estate Planning Documents (cont.)

Power of Attorney – Health Care (cont.)

- Allows principal to make election relative to life support.
  - No life sustaining treatment but ultimate decisions left to agent based on circumstances.
  - No life sustaining treatment if attending physician believes principal is in a state of "permanent unconsciousness, or suffers from an 'incurable or irreversible condition' or 'terminal condition'."
  - All possible measures used to prolong life.

Estate Planning Documents (cont.)

- Power of Attorney – Health Care (cont.)
  - Can be effective immediately or at future time.
  - Normally use statutory short form Power of Attorney (new forms as of July 1, 2011).

Estate and Gift Taxes

1) <u>Estate Tax</u> (amended as of January 1, 2011)

- Purpose – taxes the distribution of wealth to younger generation.
- Current law is effective until 12/31/12.
- Exemption - $5 million per person.
- Portability – allows surviving spouse to use Exemption of predeceased spouse that was not used in his/her estate.
  - Example – Spouse A has estate of $5,000,000 leaves everything to survivor. Spouse B can add spouse A's remaining Exemption to his/hers.
- Tax applied to taxable estate – gross estate less allowable deductions.

Estate and Gift Taxes (cont.)

- Gross Estate – all property decedent had an interest at death.
  - Real estate.
  - Investments.
  - Joint property.
  - Life insurance.
  - Employee benefit plans and IRAs.
  - Trust property, if he/she can control who receives it.
  - Property previously transferred, if control retained.
- Deductions.
  - Administrative expenses.
  - Debts.
  - Funeral expenses.
  - Marital deduction – everything passing to spouse.
- Tax rate – 35%.

Estate and Gift Taxes (cont.)

2) Gift Tax

- Annual Exclusion – Tax Free
  - Amount is $13,000 per donee per year.
  - Both spouses can give $26,000 per donee per year.
  - Example – couple has 3 children and 5 grandchildren. They can give $208,000 per year tax free (8 x $26,000).

Estate and Gift Taxes (cont.)

Gift Tax (cont.)

- Direct Gifts for Medial Care and Tuition - Tax Free.
  - Gifts must be directly to school or care give, not to donee.
  - Gifts can be for tuition (college, private school) but not for room and board or books.
  - Gifts for medical care must qualify for medical deduction.
- Lifetime Exemption
  - $5,000,000 over lifetime.
  - Reduces estate tax Exemption, dollar for dollar.

Estate and Gift Taxes (cont.)

Gift Tax (cont.)

Advantages to Lifetime Gifting

- Reduced risk of IRS audit.
- Future appreciation eliminated from estate.
- Three-year statute of limitations.
- Many non-cash gifts can be discounted for gift tax purposes.

Disadvantages of Lifetime Gifting

- Possible loss of control
- Possible loss of income

Estate and Gift Taxes (cont.)

3) <u>State Estate Tax</u>

- Illinois has an estate tax based on the state tax credit under prior Federal estate tax law.
- Credit was eliminated for Federal tax purposes but most states kept their tax.
- Illinois exemption limited to $2,000,000.
- Rate - 7.2% o 16%.
- State allows decedent to set aside an amount equal to difference between the Federal exemption ($5,000,000) and state credit ($2,000,000) into separate trust for exclusive benefit of spouse. Then won't be taxed until death of second spouse.

REMEMBER

A Well Conceived Estate Plan Can:

- Insure that your beneficiaries will get what you intend in the manner you want.
- Minimize transfer taxes.
- Protect your assets against wrong parties (IRS, creditors, divorced spouse).
- Protect your assets in the event of incapacity.
- Allow for flexibility to you and your family in the event of changed circumstances.