The Navigator

A Financial Planning Resource from Pekin Singer Strauss Asset Management

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Estate planning matters; you want to ensure that, after your death, your hard-earned assets are distributed to the people or organizations about which you care in an efficient, inexpensive, and tax-advantageous manner. Proper estate planning adds complexity to your life, but a well thought-out estate plan can make a big difference in the inheritance left for your loved ones.

The Basics of Estate Planning

by Josh Strauss, CFA

Why Do I Have To Think About Estate Planning?

Estate planning is the process by which individuals specify how their money and other property should be managed and distributed during life and post-death. The purpose of this Navigator is to present an introduction to estate planning, so that you can better understand the basics of what is involved in estate planning.[1]

Estate planning is an often neglected aspect of long-term financial planning, given the required forward-looking mentality, substantial effort, and considerable expense involved in the process. For many, it is easier to kick the can down the road and do nothing rather than try to answer tough questions such as, "What happens to my assets and my minor children when I die?" As a result, only one-third of Americans have created a will of any kind, and a much smaller proportion of people have committed the necessary time and resources to constructing a well-thought out estate plan.

A comprehensive estate plan can help you to achieve a number of important goals, including:

- Gaining confidence in the future.
- Providing support and financial stability for your spouse and/or heirs.
- Preserving assets for future generations.
- Ensuring that your assets will be distributed according to your stated wishes.
- Minimizing taxes and legal expenses associated with the distribution of your estate.
- Choosing the right individuals to make decisions for you in the event of your incapacity.
- Designating the appropriate fiduciaries for loved ones who are, for various reasons, unable to make decisions for themselves.[2]

Four Ways Assets Are Distributed After-Death

Prior to jumping into the basics of estate planning, a short explanation of what can happen to your assets after your death is warranted. Legally, there are four ways that your assets can be distributed upon your demise:

1 This Navigator is provided for educational purposes only and is not intended to be legal or tax advice. We recommend that you consult an estate planning attorney to discuss how current Federal and state/local laws apply to your specific situation.

2 A list of fiduciaries and a description of their roles is provided in the Appendix to this Navigator.

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1. ***Joint Ownership with Rights of Survivorship***
   With joint ownership, you can be co-owners of the asset with someone else (often times a spouse); when one of you passes away, the other owner automatically owns the assets outright.

2. ***Beneficiary Designations***
   Certain investment vehicles (e.g., IRAs, life insurance) allow you to specifically designate beneficiaries prior to your death.

3. ***Probate***
   Should there not be a proper will or trust in place, your assets go through a process called probate that manages, settles, and distributes your non-trust, non-beneficiary property according to the specific laws in your state.

4. ***Trusts***
   A trust is a fiduciary arrangement that allows a third-party to hold assets on behalf of the beneficiaries to the trust. A trust allows the assets to circumvent the probate process, thus saving considerable expenses and time.

Outside of the probate process, the methods listed above are relatively low cost in nature and are highly efficient for asset distribution after your death.

Estate Planning Tools

You have a number of potential tools at your disposal to optimize the overall process and minimize the costs involved in the asset distribution process. The tools that you decide to employ and the way that you choose to employ them depend on your financial situation, your family's needs, and your personal preferences.

Wills

A will is the most basic estate planning document; for many people, it represents the only estate planning document they will ever need or want to create. In its simplest form, a will tells legal authorities what should happen to your possessions when you die. If you have minor children, your will may designate the legal guardian who would raise your kids after you die. Sometimes, wills specify your children's financial guardian, whose job is to ensure that the inherited assets are distributed to your children appropriately through their minor years and in full when they reach legal age or at another specified date.

Without a will in place, you take an unnecessary risk; when you die, any assets that would be subject to probate would pass to the heirs listed in accordance with state law rather than to the individuals or charities that you might specifically wish to name in your will.

A will by itself may not be sufficient to meet your needs if one of the following is true:

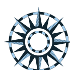
- You want your heirs to avoid the probate court process after your death. Wills can be contested in court, which makes it more likely that your heirs have to pay legal fees out of your estate.
- Your estate is likely to owe Federal and/or state estate taxes upon death.
- You want to have a higher level of control over what happens to your property after your death.
- You have a child who has a special need or disability, and you want to provide more specific management for property that will be distributed to the child after your death.
- You have children from a prior marriage, and that relationship may cause inheritance conflict with your current spouse.

If any of the parameters listed above apply to you, then you should consider setting up a trust in addition to a will.

Trusts

A trust is a legal arrangement that gives a person(s) the right to hold and manage specific assets. In a trust, property intended for the benefit of one party (the beneficiary) is held by another party (the trustee).[3] Trusts allow your assets and possessions to avoid the probate court process and be distributed directly to the intended beneficiaries post-death, thus saving considerable time and money spent on court and attorney fees. They also can help protect your estate from your heirs' creditors and, depending upon the situation,

3 The trustee and the beneficiary can be the same person, although sometimes there are many beneficiaries and sometimes there are many trustees in trusts.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your own creditors, or from beneficiaries who may not be adept at money management. In addition, a trust may allow the distribution of your assets to remain a private event, whereas probate is a matter of public record.

Trusts are geared towards individuals with high net worth. They require planning and maintenance, and they typically are much more expensive to create and maintain than a will. A multitude of types of trusts can be created for very specific purposes, and the most common variants are listed in the Appendix to this Navigator.

One key difference between types of trusts is that some are "**revocable**," which means that individuals can change the terms of the trust at any point in time. Other trusts are "**irrevocable**," which means that those assets which are placed into the trust cannot be retrieved because they no longer belong to the grantor. The advantage to an irrevocable trust is that it typically transfers your assets out of your estate and out of reach of estate taxes and probate. Thus, an irrevocable trust can be preferable if your primary aim is to minimize estate taxes.

Today, the most common type of trust is a revocable living trust, which can allow you to enjoy and control the trust's assets during your lifetime and then automatically shift ownership of the property in the trust to a named beneficiary(s) upon your death.

Other Important Estate Planning Tools

Depending on your circumstances, other types of estate planning documents are worth your consideration, such as a **powers of attorney** (POA) for finances. This document allows you to name a trusted person to handle your financial matters if you become unable to handle them on your own. A POA is largely preventive; if you do not have a POA and you become mentally incompetent, a judge will appoint someone of his/her choosing to manage your non-trust finances for you, even if the appointee is unfamiliar to you or your financial situation.

Another important estate planning document is a **health care directive**. Sometimes called an **advance health care directive**, this document allows a designated power of attorney for health care to instruct health care providers about what life-prolonging treatments, if any, you wish pursued if you are unable to express your desires. Beyond that, it names an individual to oversee your care to make sure that your wishes are enforced.

A **final arrangements document** will give legal force to your wishes for body and organ donations, as well as your funeral procedural preferences.

Estate & Gift Taxes

An important reason to create an estate plan is to minimize estate-related taxes. Estate and gift taxes are part of a transfer tax system that is separate from and incremental to the income tax system. These taxes can be punitive if the size of your estate is significant, and it is important to understand how they work in order to maximize the after-death value of your estate to your heirs.

Gift taxes apply to certain transfer of assets or interests in property that you make to another while you are still alive. As of 2018, you can gift up to $15,000 in assets per person annually without those gifts counting against your $11.18 million lifetime gift exemption. The annual gift tax limit is expected to increase over time by the inflation rate but is generally indexed in $1,000 increments.

For example, if you are married and want to give property to your two children, you can give $15,000 per person, as can your spouse. Thus, each child could receive up to $30,000 in property per year ($60,000 in total gifts) without the gifts counting against your lifetime gift exemption.

While gift taxes apply while you are alive, **estate taxes** are associated with distributing your property after death. As of 2018, a deceased estate is not subject to estate tax at the Federal level until its value is in excess of $11.18 million, less the amount you have gifted beyond your annual exclusionary limit.

That means that you can leave up to $11.18 million to your heirs and pay zero Federal estate taxes. Similarly, a married couple will be able to shield up to $22.36 million ($11.18 million times two people) from Federal estate taxes. As a result, over 99% of U.S. taxpayers do not have to worry about the Federal estate tax diminishing what they plan to leave to their loved ones. However, any assets distributed to heirs above the $11.18 million minimum would be taxed on the Federal level at a flat 40% rate.

At the state level, there are additional estate and gift taxes that are incremental to any Federal estate and gift taxes, often with exemption levels that are lower than the Federal thresholds.

Estate Planning Rules of Thumb

For most of us, estate planning is a complicated area that is chock full of myths and misconceptions. The list of rules of thumb provided below should help to eliminate potential errors, identify pitfalls, and minimize confusion for you and your heirs.

Hire a Capable, Trustworthy Lawyer

Hiring a competent attorney is the first step for getting started on your estate plan. There are several good ways to find a qualified and appropriate estate lawyer. You can ask us for a referral, speak to friends and colleagues about their experiences with their respective estate lawyers, and/or visit the website of the American College of Trust and Estate Counsel (www.actec.org), an association of estate planning attorneys.

Utilize a Roadmap for Heirs

When a loved one passes away, heirs are often burdened with substantial responsibilities relating to the estate division and other personal matters. Heirs' responsibilities may include preparing funeral arrangements, reconciling financial accounts, selling assets, and coordinating various commitments. To mitigate the stress and confusion that your heirs will inevitably experience after your death, we recommend you assemble a detailed outline of your personal affairs (*Roadmap for Heirs*) and share it with loved ones and key advisors.

Keep Your Will or Trust Current

As your asset base grows and your family situation changes over time, your estate plan should be revisited and updated periodically (probably every 5-7 years) to reflect your changing needs.

Gift Strategically

Your estate lawyer should help you to think about appropriate asset transfer strategies to utilize while you are alive. Examples include:

- Gifting assets annually to your heirs up to the maximum amount.
- Paying tuition or medical expenses directly on behalf of your heirs. You can transfer an unlimited amount of money in this manner, as long as you make payments directly to the medical provider or educational institution.
- Donating capital to qualified charities.
- Contributing to Section 529 college savings or prepaid tuition plans.

Communicate Early & Often

You should begin having conversations with your beneficiaries sooner rather than later. Inform them what they need to know when you die, where your *Roadmap for Heirs* is located, and who will be responsible for specific tasks. If they have little experience or knowledge about investing and estate planning, it will be helpful to start educating them early.

Conclusion

While rushing through life and trying to complete your daily tasks, one of the last things on your mind is paying the money associated with writing a will or thinking about putting your assets in trust. However, properly addressing these issues can ensure that you leave loved ones properly cared for, minimize disagreements among possible heirs, and prevent unnecessary attorney fees from eating away at your assets. Should you wish to discuss the contents of this Navigator in more detail, please feel free to reach out to us.

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FIDUCIARIES

Estate planning requires the assignment of various roles, some of which have been previously mentioned. These roles are typically defined as fiduciaries, which are individuals in a position of trust who have legal obligations or duties to act with care and loyalty and in the best interest of another party. An important part of the estate planning process involves the careful selection of these individuals or entities that you have entrusted to carry out your estate plan.

- ***Executor***
  The executor is the person or entity responsible for gathering your individually-owned assets following your death, managing and maintaining your assets, completing all the administrative and tax responsibilities of your estate, and distributing your assets according to your express wishes, as stated in your will.

- ***Guardian***
  This individual is responsible for the physical, day-to-day care of your minor children following your death.

- ***Trustee***
  This fiduciary has the responsibility for investing and managing the trust assets, distributing the assets in accordance with the terms of the trust, keeping accurate records, and filing tax returns. You can be the trustee for your living trust if you so desire, but you should appoint the trust's successor trustee as well. In certain circumstances, the use of a corporate trustee can be valuable; the Bank of NY Mellon (the parent company of Pershing Advisor Solutions) and Charles Schwab offer corporate trustee services to their custodial clients for a fee.

- ***Estate Planner***
  This lawyer prepares documents and helps to execute the transfer of your wealth and assets after your death.

- ***Investment Advisor***
  Your portfolio manager is required by law to exercise the highest level of care, prudence, and loyalty in the management of your assets. This fiduciary duty applies with our clients when they are alive and with their estates after they have passed away.

- ***Health Care Agent***
  This person is responsible for making medical decisions on your behalf in accordance with the express directions outlined in your advance health care directive.

- ***Power of Attorney for Finances***
  This fiduciary exercises responsibility for taking care of you and your property if you are mentally incompetent and need a third-party to assist you in managing your financial affairs.

BASIC TYPES OF TRUSTS

- ***Marital or "A" Trust***
  Designed to provide benefits to your spouse: generally included in the estate of your spouse.

- ***Bypass or "B" Trust***
  Established to bypass your spouse's estate to make full use of any Federal estate tax exemption.

- ***Testamentary Trust***
  Outlined in a will and created through the will after your death; often is subject to probate court supervision.

- ***Irrevocable Life Insurance Trust***
  Designed to exclude life insurance proceeds from your taxable estate, while providing liquidity to the estate.

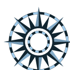
- ***Charitable Lead Trust***
  Allows certain benefits to go to a charity and the remainder to your beneficiaries.

- ***Charitable Remainder Trust***
  Allows you to receive an income stream for a defined period and stipulate that any remainder of the assets be distributed to a charity.

- ***Generation-Skipping Trust***
  Permits assets to be distributed to your grandchildren or later generations without incurring either a generation-skipping tax or estate taxes on the subsequent death of your children.

- ***Qualified Terminable Interest Property Trust***
  Used to provide income for your spouse. Upon your spouse's death, the assets then go to additional beneficiaries named by you.

- ***Grantor Retained Annuity Trust***
  Designed to shift future appreciation on appreciating assets to the next generation during your lifetime, thus avoiding estate taxes that would otherwise be applicable on that appreciation after your death.



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