

WEALTH CARE KITSM



Estate Planning

SmartAboutMoney.org

A website built by the National Endowment for Financial Education dedicated to your financial well-being.

You may not own a 50-room, 100 acre estate, but you have an estate nonetheless.

And it is probably larger than you realize. An estate incorporates everything you own. Your home, cars, jewelry, and other tangible possessions probably come to mind first. But an estate also may include insurance policies, savings and checking accounts, a small business, and retirement funds.

You also have an estate plan, whether you realize it or not. The question is, do you have a planned estate? Are your financial and personal interests organized so that, upon your death, your wishes will be met with a minimum of inconvenience and expense to your estate and family? Or, because of the failure to plan, will the state dictate the distribution of your assets?

Be aware that an estate plan involves more than just writing a will. A will is an important estate planning document. Yet a simple will under which you leave everything to your spouse may actually end up costing you unnecessary estate taxes.

People are understandably reluctant to plan their estate. Estate planning is complex and time consuming, and it means confronting the inevitability of death and potential family conflicts. But the benefits of planning far out-

weigh any potential difficulties.

Estate planning can:

- Ensure that your estate will be distributed according to your wishes.
- Minimize taxes and expenses associated with that distribution.
- Provide adequate financial resources to pay for any estate taxes without forcing the sale of assets.
- Minimize or eliminate probate.
- Provide for the financial support and guardianship of your children.
- Minimize or eliminate potential family conflicts over your possessions.
- Organize the distribution of your estate to make it emotionally and financially easier on your heirs.
- Provide for effective management of the estate.
- Outline your preferred treatment should you become physically or mentally incapacitated.
- Ensure the successful transfer of a closely held business interest.

DETERMINING THE VALUE OF YOUR ESTATE

Before you can effectively plan your estate, you have to determine what's in it. Your net estate is a snapshot of the current financial health of your estate: your total assets minus your liabilities. The checklist of assets and liabilities on page 4 should give you a good start. Gathering and organizing your financial records will save you time and money when you consult with a professional advisor.

Beyond determining what assets you have, it's important to determine how the assets are owned. People frequently overlook the issue of asset ownership. In marriages, many assets often are owned jointly with right of survivorship. One advantage of this arrangement

between spouses is that assets automatically pass to the surviving spouse outside of probate. But this arrangement may not always be the wisest one, depending on your desires or the family's needs. In some cases, it can result in unnecessary taxation, for example, or prevent other persons (such as a friend or child) from receiving desired assets. A financial planner or estate planning expert can help you choose the best way to title your assets.

Once you've identified ownership of your assets and liabilities, determine to whom you want to distribute your assets—from stocks and bonds to your golf clubs. Don't overlook designating primary and contingent beneficiaries for IRAs and qualified retirement accounts, such as 401(k), profit sharing, and pension plans.

A useful document to include is a letter of instructions. It's not a legal document, but it provides the executor of your estate with information and instructions about your personal and financial matters. It lists the location of financial accounts and important papers, potential death benefits, funeral instructions, assets and liabilities, and so on. The letter can help family members at a time of great stress.

EVERYONE NEEDS A WILL

While a will may not provide sufficient estate planning, it certainly is a document that most adults should have. If you die without a will—known as dying “intestate”—the distribution of assets may go against your wishes. Yet 50 percent of Americans die without a will.

A will directs which assets you want distributed to whom. If you want a

portion of your estate to go to a specific charity, but you die without a will designating that charity, your wish won't be fulfilled. A will also can direct what assets are to be used to pay for taxes and final expenses, name guardians for your children and personal representatives (executors) for your estate, and establish trusts for dependents. It's critical to have a valid, up-to-date will. Estate planning laws and personal circumstances and desires change. Review your will if you haven't done so lately, especially if the will was written before 1982 (due to tax law changes). Also, what a will can and cannot do and how to execute a valid will varies from state to state, so if you have recently moved, the will should be reviewed by an experienced local attorney.

Choose the executor of your estate carefully. Typically, a friend or relative may be fine. But the executor has important financial and personal duties to carry out, including collecting and reviewing all financial records, seeing that probate forms are filed, preparing estate and income tax returns, and distributing assets according to your wishes. Naming someone who is trustworthy and competent is essential.

OTHER IMPORTANT DOCUMENTS

Besides a will, you should have at least these other basic estate planning documents: a durable power of attorney, a living will, and a medical durable power of attorney and/or a health-care proxy. These tools can be vital in administering and preserving your estate. Some of this terminology varies from state to state.

A *durable power of attorney* is a legal document ensuring that if you can no longer manage your financial and personal affairs, a designated

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representative will act on your behalf. Powers of attorney can be either broad or limited, and for an indefinite or specific length of time. In some cases, you may want to consider a living trust instead of, or in addition to, a durable power.

A *living will* is a statement of your personal wishes as to what life-sustaining medical treatment you want or don't want should you become comatose and terminally ill. Along with a living will, a medical durable power of attorney and/or a health-care proxy add additional security. These documents designate a representative to make medical decisions on your behalf.

ESTATE AND GIFT TAXES

Now that you've determined your estate's value and arranged for the preparation of your will and other important estate planning documents, let's turn our attention to the subject of estate taxes.

In 2005, you can own an estate with a value of up to \$1.5 million and owe no estate taxes at death. In 2006, the estate tax exemption jumps to \$2 million and increases to \$3.5 million by 2009. Any portion of your taxable estate above this threshold is taxed at a minimum of 45 percent to the maximum of 47 percent for 2005 (the rate declines until 2010).

“No problem,” you say confidently. “My estate won't be worth close to \$1.5 million!”

Don't be too sure. With appreciated home values, sizable retirement plans, and the death benefits of life insurance policies, you may be closer to that threshold than you realize. Furthermore, your estate will likely grow in value over time, perhaps eventually passing the threshold.

Space prevents an exhaustive list of strategies for reducing or eliminating potential estate taxes, but a few to consider are:

- Gifting present interest property during your lifetime (up to \$11,000 a year per recipient free of tax, \$22,000 jointly with the consent of your spouse); these amounts are indexed for inflation, but will only increase in \$1,000 increments, and thus may not change every year
- Paying for medical services or college tuition directly to the institution for the recipient
- Donating to charities (unlimited)
- Establishing an irrevocable trust for appreciating assets or life insurance
- Funding a 529 plan for college savings

TRUSTS

Although many estates don't need trusts, trusts can benefit more estates than you might think. A trust is a legal arrangement in which a person (the grantor) transfers the ownership of assets (real property, money, insurance, etc.) to another person, persons, or organization (trustee) to hold for the benefit of the grantor's named beneficiaries.

There are many types of trusts, but, in general, a trust can be operative while the grantor is alive (a living trust or inter vivos trust) or becomes operative at death (testamentary trust).

A living trust can be revocable or irrevocable. A revocable trust allows the grantor to retain total control of the trust assets. This doesn't provide income or estate tax advantages, but it can reduce probate costs, avoid publicity, and maintain some control of the assets even after death.

Under an irrevocable trust, the grantor or creator of the trust gives up permanent control of the assets transferred to the trust. This type of trust not only reduces probate costs, but may protect the assets from creditors and usually results in estate tax savings if it's structured properly.

One of the big advantages of trusts is that they can be tailored to meet specific estate planning needs. For instance, while a simple will gives assets outright to beneficiaries, a trust can specify conditions about how and when the assets are to be distributed. The trust document might instruct that a child not receive the assets until he or she

reaches a certain age. Other uses for trusts include:

- If you have a disabled child, or children of different economic circumstances, a trust can be established to enable the trustee to distribute trust assets according to the needs of the beneficiaries.
- A trust can ensure that your assets are professionally managed should you become incapable of managing your own affairs.
- Insurance trusts can be set up to keep insurance proceeds out of the grantor's estate.
- Trusts can be good vehicles for making substantial donations to charitable organizations.
- In cases of remarriage and/or stepchildren, a trust can be set up to ensure that the children of your first marriage inherit some or all of your estate upon the death of your second spouse.

PROFESSIONAL ADVICE

Trusts are complex creations, and they can be expensive to establish and maintain. An attorney should be involved to ensure that the trust is properly established and managed to avoid any legal or tax complications.

Choosing an individual or a corporation to act as a trustee is an important consideration. Beyond the issues of trust and competence one applies when selecting the executor of a will, for example, a trustee may need to administer the trust well into the future. Depending on the size, complexity, and objectives of the trust, you may want to consider a bank trust department or other professional organization to handle the administration.

So whether you have a modest or a sizable estate, whether you are young or old, begin an estate plan today. It may be the best gift you can leave your heirs.

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ESTATE PLANNING CHECKLIST

To develop a comprehensive estate plan, you'll need to gather a wide variety of data and make numerous decisions. This checklist is provided to help you organize your thoughts and actions.

Yes	No	NA	
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Do you have a current will? Do you need to change any named beneficiaries?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you identified all of your assets and liabilities?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Do you know your "basis" in these assets? (Generally, your basis is equal to what you paid for an asset acquired through purchase.)
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Do you know the fair market value of each of these assets?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Do you know how each of these assets is titled? Do you own them individually or as a joint tenant or tenant-in-common with a spouse or other individual?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Do you have copies of all life insurance policies? Do you know who the "owner," "insured," and "beneficiary" of each of these policies is?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Do you know how your bank accounts are titled? Do they have a payable-on-death provision?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Do you know what will happen to the assets in your retirement plan upon your death?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Will payments to your surviving spouse continue after your death? To whom will any remaining assets be distributed?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you identified an appropriate guardian for any minor children? Have you discussed your wishes with this individual, and has he or she agreed to serve as guardian?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you identified an appropriate executor to administer your estate? If so, have you discussed your wishes with this individual, and is he or she willing to serve as executor?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you estimated your estate tax liability? Have you considered ways to reduce this tax liability?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you considered how your estate plan affects the estate of your surviving spouse and the amount of estate tax he or she will owe upon death?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you determined how any estate tax due will be paid? Will your estate have sufficient liquidity, or will it be necessary to sell assets to pay the tax?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you considered making lifetime gifts or setting up trusts during your lifetime as a part of your overall estate plan?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	If you are the owner of a closely held business, have you considered what will happen to the business after your death?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you decided how you want your assets distributed upon your death?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you decided whether you want to make specific bequests to certain beneficiaries, and if so, what do you want to leave to whom?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you decided to whom you want to leave the balance of your estate (the residual) after any specific bequests have been made?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you thought about how your estate plan will be affected if a named beneficiary dies before you do? Who should get his or her share of your estate?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Have you decided whether you would like any charitable donations to come out of your estate?

ESTATE PLANNING CHECKLIST cont.

- | Yes | No | NA | |
|--------------------------|--------------------------|--------------------------|--|
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | If your estate plan will include setting up trusts, either at the time of your death (a testamentary trust) or during your lifetime, have you decided who will serve as trustee? |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | What will his or her duties be? |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | Have you decided whether you would like any charitable donations to come out of your estate? |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | If your estate plan will include setting up trusts, either at the time of your death (a testamentary trust) or during your lifetime, have you decided who will serve as trustee? |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | What will his or her duties be? |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | Have you decided the type of funeral arrangements you would like and what should be done with your remains? |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | Have you considered what you want to happen if you are terminally ill? |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | Do you wish to have a “living will” or health-care proxy? |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | Have you decided who should handle your affairs if you are incapacitated? |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | Do you want a durable power of attorney? |