

# Thinking the Unthinkable: What Everyone Needs to Know About Estate Planning



FINANCIAL PLANNING ASSOCIATION

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## **You already have an estate plan**

Did you know you already have an estate plan? The only question is whether it is the estate plan you want—the one that's best for you and your family.

Anyone who owns assets has an estate, whether those assets fill a 50-room mansion or a shopping cart. Upon a person's death, those assets must, by law, be properly distributed. Exactly which assets are distributed to whom depends on the estate plan. Without proper planning, a court could determine their distribution in accordance with state law, which may not fit the wishes of the deceased.

This brochure, prepared by the Financial Planning Association (FPA), shows why you need an estate plan and highlights some of the basic components of an estate plan. A CFP professional, working in conjunction with your estate planning attorney, can help you design a sound, cost-effective estate plan that complements your overall financial circumstances.

## **Why you need an estate plan**

Many people assume that estate planning is only about saving estate taxes. Consequently, they often ignore estate planning because they assume that their estate is too small to be taxed. Yet increased home values, larger life insurance policies and larger retirement accounts often make estates more vulnerable to taxes than their owners may realize.

Furthermore, many families assume that because Congress has reduced federal estate taxes—and may permanently eliminate them—they either don't need a formal estate plan or they can delay work on one. Regardless of what Congress ultimately decides regarding federal estate taxes, many estates—even modest-sized ones—will remain vulnerable to state inheritance and estate taxes. But the main reason that everyone needs an estate plan is that it is much more than about taxes.

Additional benefits include:

- Making sure your assets go where you want them to go
- Controlling assets while you are alive but incapacitated
- Controlling assets after death
- Minimizing the emotional and financial burden on your heirs
- Minimizing feuding among heirs over your estate
- Increasing the amount available for charitable donations
- Avoiding the cost and delay of probate
- Providing provisions for a guardian of minor children

## **The elephant in the living room**

Despite the benefits, estate planning is, for many families, the elephant in the living room that everyone avoids talking about. There are several reasons for this, including:

- Many don't want to face a subject that ultimately is about mortality
- It may dredge up family conflicts
- Many don't want to talk about money with their heirs
- Parents don't want to spoil the kids with money or don't trust their kids with money
- Many are hesitant to invest time and money into developing an estate plan

But the elephant will not go away. Delay or avoidance can prove costly not only from a tax standpoint, but in unnecessary conflicts, anger, time and confusion among the heirs.

## **Start with estate's assets and your wishes**

A good way to get started is to calculate your current net worth. Your net worth statement, sometimes called a balance sheet, details what assets you own, in whose name, what beneficiaries may be designated and the asset's value. Your net worth is the total value of these assets minus all your debts.

The result is a snapshot of the current financial health of your estate and provides a benchmark against which future progress (or lack of progress) can be measured. It also shows whether you have a potential tax problem that you need to address.

But most important, reviewing your estate's assets (including your favorite easy chair and golf clubs) starts you on the road to deciding where and how you want those assets to go. What do you want your spouse, children, relatives or close friends to have? Are they capable of managing it, or might a trust be necessary? Do you want to give some of it to charity—during your lifetime or after death? What do you want to do with your business—sell it or pass it to the next generation?

Once you have a clear idea of what you want to do with your property, you can begin exploring, with the help of your financial advisers, what tools and strategies can make that happen with the most efficiency at the least cost. It's also important that this planning be done in the context of your current overall financial circumstances.



## The four fundamental estate planning tools

Regardless of the size of your current estate, you generally should have as a minimum four estate planning tools: a will, a durable power of attorney, a living will and a medical power of attorney.

While you can save money by creating some of these legal documents on your own with software or standardized forms, most adults should have a competent estate planning attorney draft the documents. For one thing, a local attorney can make sure the will conforms to your state's laws. A professionally drafted will further ensures against legal challenges and the failure to include important details. Improperly drafted or last-minute, hand-written wills frequently are contested and invalidated in court.

These documents often can be drafted for as little as a few hundred dollars to a couple thousand dollars each, depending on what area of the country you live in and how simple or complex your needs are. But preparing now can save your heirs much grief and expense later.

**A will** – A will is a legal document that details where you want your estate's assets to go (after debts and taxes are paid) and who is going to oversee the execution of the will. It also may state who is to care for your minor children.

Without a will, the laws of the state will determine what happens to your estate's property. Your spouse, children or other heirs could end up with less than you planned, the assets could be poorly managed, your children might not have the guardian you wished, or your estate could end up paying more in taxes and legal fees than necessary.

Keep in mind that a will does not supersede everything else in your estate plan. For example, if your will lists your wife to receive your entire estate, but your ex-wife is the primary beneficiary of your life insurance policy and retirement account, then your ex-wife would likely end up with the benefits.

**Durable power of attorney** – A power of attorney is a lifetime document for estate planning. It allows you to designate a representative; such as your spouse or adult child, to perform certain actions for you should you become ill, incapacitated or otherwise unable to manage your affairs. The representative could, for example, pay bills, sell securities or make major financial decisions on your behalf, depending on how broad or narrow you limit the powers. Without a power of attorney, your spouse or other loved one would have to go through the delay and expense of seeking approval from the court to carry out needed financial transactions.

**A living will** – A living will is an individual's written declaration of what life-sustaining medical treatments he or she will allow or not allow in the event they become incapacitated. For example, the person may request that artificial nourishment be or not be withheld if he or she is terminally ill.

Family members or medical institutions often challenge the meaning or validity of living wills, so take considerable care and be specific when drafting it. States provide standard-language forms, but some experts feel they are too vague.

**A medical durable power of attorney (or health care proxy)** – This document authorizes a person to make medical decisions on your behalf, ideally to carry out what you've specified in your living will. Talk to the person before appointing them, and be sure they understand and are comfortable with your wishes, and will be strong enough to carry them out even though some family members may object.



## Additional estate planning tools

You may also need to use additional estate planning tools depending on the size and complexity of your estate. These tools may be useful for reducing potential estate taxes, but they can also serve other purposes.

**Trusts** – Trusts are legal vehicles for managing assets solely for the benefit of a trust beneficiary, and are typically less vulnerable to legal challenges than wills. Of the over 50 trusts available, not all can or should be used to save estate taxes. The popular living trust, for example, does not reduce estate taxes. Other purposes that trusts can serve include:

- Managing money for an heir who is too young or financially incompetent
- Provide continuity of management in the event of incapacity
- Requiring an heir to meet certain standards, such as being drug free or graduating from college, in order to inherit money
- Ensuring that a person's assets go to their children rather than the surviving spouse's children from a previous marriage
- Financially assisting a disabled child without disqualifying the child for government assistance
- Reducing income taxes and providing income for the donor while leaving more benefits for the charity
- Protecting assets from creditors
- Reducing the cost and public exposure of probate
- Controlling the inheritance for a troublesome heir instead of simply disinheriting the person. Disinheritance often provokes ill feelings not only toward the estate owner but also toward those who actually inherit.


**Ownership of assets** – Who owns what assets in a family can have a significant impact on an estate plan. For example, most couples own property jointly, “with rights of survivorship.” Upon the death of one spouse, the jointly owned property automatically passes directly to the surviving spouse, avoiding probate.

While this is an appropriate choice for many couples, it's not the best choice in all situations. For example, you may want property separately owned so it can pass into a trust and take better advantage of the estate tax exemption or be protected for the surviving spouse and heirs. You may want some property separately owned so that it passes to the children from a previous marriage, or so that a spouse isn't liable for the other spouse's debts.


**Insurance** – Insurance can serve several purposes in estate planning.

- Provide family protection in the event of premature death
- Protect your estate's assets from catastrophic loss or lawsuits
- Can be an asset passed on to heirs or charities
- May be used to pay for estate taxes
- A small business owner may use life insurance to provide an equitable share to heirs who won't run the business
- Co-owners in a small business often use life insurance to buy out the deceased's estate.

The ownership of life insurance bears careful scrutiny for estate planning. Estate owners often mistakenly own large amounts of life insurance to help pay for estate taxes. While the death benefits are not subject to income tax, they may be subject to estate tax. Consequently, the insurance benefits earmarked to pay estate taxes on other property end up themselves being taxed. One strategy around this is to use an irrevocable life insurance trust, in which the estate owner is the insured but the policy is actually owned by the trust and thus generally not included in the insured's estate.



**Less expensive strategies** – If estate taxes are an issue, keep in mind less expensive tax strategies such as gifting. For example, you can give away \$12,000 (indexed for inflation) every year to each person you choose, free of gift tax. A couple could give a grandchild \$24,000 a year, for example. You also can pay the tuition bill or a medical bill for a favorite grandchild or niece free of gift tax, as long as you pay it directly to the institution.



### **Business owners**

Estate planning is essential to anyone who owns a business because typically the business is the largest asset in the owner's estate. Again, this is not just an estate tax issue, but a concern of what will happen to the business. Only four in ten family businesses survive after being transferred to the next generation.

While estate taxes sometimes play a role in this failure, more often it is due to lack of good succession planning. The owner, for example, fails to groom a qualified successor or tries to divide the business evenly among the heirs, causing control conflicts. Sometimes the best decision is to sell before death and not pass on the business. Like other aspects of estate planning, succession planning involves the issue of mortality and family conflict, therefore planning is frequently postponed until it is too late.

### **Discuss your estate plan with family**

As in the case of a family business, or any estate for that matter, the owner can dramatically smooth the passing of the estate's assets by discussing the estate plan in advance with the heirs. Heirs, stressed by the loss of a loved one, frequently feel uncomfortable, even guilty, about receiving an inheritance. Good planning and prior discussion can relieve much of their anxiety about receiving and managing the inheritance.

Keeping your estate plan a secret can also spark a bitter feud among the heirs over the distribution of the estate's assets. An AARP study found that one in five people over the age of 50 have experienced family conflict concerning inheritance issues.

Explain to heirs why you've made certain decisions, especially if it isn't a simple matter of dividing liquid assets such as cash and stock evenly among them. Who will run the family business? Who gets the vacation home? Who receives which heirlooms and memorabilia? Listen to their feedback and revise plans, if appropriate. Explaining your living will and medical power of attorney can minimize inter-family conflicts over your medical treatment should you become terminally ill, as well as minimize family anxiety about your wishes.

## **The most important letter you may ever write**

A simple letter of instruction, written in tandem with your will, may be the most important letter you will ever write. Not only will it provide your immediate family with information they may need, it also ensures that your affairs will be handled as you wish.

The letter may include:

- The type of funeral you prefer and any prearrangements you made with the funeral home and/or minister
- The contact information for each of your insurance policies including Medicare
- A financial statement listing your accounts and any outstanding loans
- The location of important papers and the key to your lock box or combination to any locked containers
- Persons to contact such as relatives, friends and advisers
- An obituary listing your name as you wish it written, including nicknames, place and date of birth, immediate relatives and any noteworthy accomplishments

When you complete your letter of instruction, inform someone close to you where you are keeping it. Except for an occasional update, forget about it and enjoy life, knowing all is in order.

## **Keep organized financial records**

Perhaps heirs find nothing more frustrating at a time of grief than digging through disorganized and incomplete financial records. Keeping good records—what assets you have, where they are located and how to get in touch with the appropriate financial advisers— can save your heirs immense headaches, reduce the chance of costly errors and ensure that all assets and debts are accounted for.

Take care to document the cost basis of your assets. The cost basis is what you paid for an asset, plus possible adjustments. This will become particularly important should the estate tax be replaced with a capital gains tax on assets passed to heirs.

## **Review your plan periodically**

Review your estate plan regularly—particularly such components as wills and trusts. Tax laws change, personal circumstances change and your net worth may increase or decrease, necessitating revisions to your plan.

## **Coordinate your estate plan with planner and attorney**

While some CFP professionals are qualified estate planning attorneys, most planners work with outside attorneys. Both professionals need to work closely together because it's important that the estate plan and any accompanying legal documents work in tandem with other elements of your overall financial plan, such as investments, saving for retirement or putting children through college.

## **How can I contact a CFP professional?**


To find a CFP professional in your area, please call FPA at 800.647.6340 or visit [www.plannersearch.org](http://www.plannersearch.org).




## Estate Planning Checklist

- ☐ Start by reviewing estate assets and debts
- ☐ Decide where you want assets to go
- ☐ Start work with a financial planner and attorney
- ☐ Draft or update a will
- ☐ Choose a qualified executor for will
- ☐ Choose guardians for children
- ☐ Secure a durable power of attorney
- ☐ Draft a living will
- ☐ Obtain a medical power of attorney
- ☐ Consider creating one or more trusts
- ☐ Review ownership of assets
- ☐ Review insurance for protection of estate assets
- ☐ Consider annual gifting
- ☐ Consider paying heirs' tuition or medical bills
- ☐ Determine whether to sell or pass on family business
- ☐ Plan for succession of business
- ☐ Discuss estate plan with heirs, and revise if appropriate
- ☐ Write a letter of instruction
- ☐ Keep organized financial records
- ☐ Review estate plan periodically
- ☐ Coordinate estate plan with qualified estate planning attorney and financial planner

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