LEARNING MADE EASY

2nd Edition

Estate Planning

for dummies®
A Wiley Brand

Pass along money and property, not your tax burden

Organize your assets and help heirs bypass probate proceedings

Plan for your estate with wills, trusts, POAs, and more

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Estate Planning

2nd Edition

by Jordan S. Simon and
Joseph Mashinski

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Estate Planning For Dummies®, 2nd Edition

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Contents at a Glance

Table of Contents

Introduction

Even if you're not a zillionaire who owns multiple houses, a couple of boats, and some hefty bank accounts, you still have an estate. And with that estate comes the requirement to take control of what happens to all your belongings, no matter how much — or how little — you actually have. After all, you can't take it with you!

So how do you take control of what happens to your estate? With planning! Welcome to the world of estate planning.

Estate planning applies to everyone, yet a surprising number of people either have only done a very small part of what they need to do (usually just creating a will, which very often is out of date) or perhaps have done absolutely no estate planning at all!

That's where *Estate Planning For Dummies* comes in. This book is especially intended for you if you:

- Have done very little or nothing on your estate planning so far and feel so overwhelmed that you don't know where to start
- Have done bits and pieces of your estate planning, but all those parts are disjointed, and you're concerned that you have lots of holes in your estate planning
- Are concerned that you may have serious shortcomings or even outright mistakes in what you've put in your will, how your insurance policies are structured, and other aspects of your estate planning
- Have done a fair amount of work on your estate planning, but in a haphazard, undisciplined manner
- Realize that estate planning is an ongoing, lifelong proposition and you want to become more disciplined in how you approach your will, estate tax planning, and all the rest

In short, *Estate Planning For Dummies* can help you no matter where you are in the estate-planning process.

About This Book

Estate Planning For Dummies is written in easily understood language from cover to cover, with liberal use of examples. Some of the topics we cover are very basic — the estate-planning fundamentals we cover in Chapter 1, for example — while other material, such as the chapters on trusts, is more advanced and complicated.

If you're considering estate planning for the first time, you may want to skim through the book cover to cover just to get an idea of what's here, and then settle down and use the book as a reference on specific topics as they come up. If you've had a bit more exposure to estate planning, you may want to selectively read certain chapters, and either skip or skim others. We recommend at least skimming every chapter, even if you currently have (for example) a will, a few trusts, and various types of insurance policies, and understand the basics pretty well.

Foolish Assumptions

The most important assumption we've made about you is that you're ready to dive into estate planning or at least are curious about what estate planning involves. Maybe you already have a basic will, but time has passed since you prepared that will and your life has become more prosperous — and complicated — and you need to look into trusts, will substitutes, estate tax considerations, and many other topics that make up your estate.

Perhaps you used an online will preparation website or even created a simple trust using a website that helps customize a trust to your particular needs. Congratulations — that's a great start! But as you'll see in this book, estate planning is about much more than simple wills and trusts. Modern family situations can get very complicated, and your wishes for your estate could be equally complicated . . . or maybe even convoluted. Fear not! No matter what your particular estate situation happens to be, just follow along, and we'll walk you through both simple and complex decisions and steps that you need to make.

Icons Used in This Book

As with all *For Dummies* books, icons in the margins call your attention to various points we make (or try to make!) about estate planning.

TIP

When you see the Tip icon, the accompanying material is some action you should consider taking to make your life easier.

WARNING

The Warning icon is exactly that: a warning of some dire consequence that may occur should you make the wrong move with your estate planning.

TECHNICAL STUFF

When you see the Technical Stuff icon, the accompanying material falls into that category of "Thanks, but that's more than I really needed to know." You can certainly get the gist of any chapter's contents by skipping all the Technical Stuff material, but if you want to get "under the hood" for that chapter's topic, a few moments spent with this technical stuff can help you thoroughly understand that topic — just like the estate-planning professionals!

REMEMBER

The Remember icon highlights the key point or two that can help you be a better estate planner.

Beyond the Book

In addition to what you're reading right now, this product also comes with a free access-anywhere Cheat Sheet. There you can find quick reference material about wills, trusts, and other important estate-planning topics. To get this helpful content, simply go to `www.dummies.com` and type **Estate Planning For Dummies Cheat Sheet** in the Search box.

Where to Go from Here

Now it's time to dive into the world of estate planning. If you're totally new to the subject, you won't want to skip the chapters in Part 1 because they provide the foundation for the rest of the book. If you've already started your estate planning with a basic will and maybe a simple trust, we still recommend that you at least skim Part 1 to get a sense of how to get beyond all the hype, buzzwords, and generalities related to estate planning.

From there, you can read the book sequentially from front to back, or jump around as needed, using the table of contents and index as your guide. Whatever works best for you is how you should proceed.

1 Getting Started with Estate Planning

IN THIS PART . . .

Get the straight scoop on all your estate-planning needs.

Tally up everything that needs to figure into your estate plan.

IN THIS CHAPTER

- » Understanding what your estate is
- » Planning what will happen to your estate
- » Realizing that your estate-planning goals are different from other people's
- » Comprehending estate-planning lingo
- » Stepping onto the critical path for estate planning
- » Putting together your estate-planning team

Chapter 1

Congratulations: You Have an Estate!

The protection and control that you need.

No, the above phrase isn't the marketing slogan for a new deodorant. Instead, it expresses the two most important reasons for you to spend time and effort on your estate planning:

- » After you die, the government will try to take the portion of your estate that the current tax law says it's entitled to, but you have the opportunity to protect your estate by minimizing that tax bite.
- » You want to have as much control as possible over how your estate is divided up. Basically, you want to decide what will happen to your estate rather than have a jumbled set of complicated laws dictate who will get what.

You may have spent time working on a financial plan throughout your life, as well as crafting your retirement plan. Your estate plan accompanies those other two plans and makes up the third leg that supports your life's overall "financial stool."

WARNING

Without a solid estate plan, however, your "financial stool" can't stand on just those two other legs. Even worse, even though you may not be around to witness the complications and damage, all your hard work on your financial and retirement plans could be severely compromised in the absence of a solid estate plan.

Before you can plan your estate, you need to understand what your estate really is. Many people think that for the average non-billionaire, estate planning involves only two steps:

- Preparing a will
- Trying to figure out what inheritance and estate taxes — the so-called "death taxes" — apply (and if so, then how much money will go to the state and federal governments)

But even though wills and death taxes are certainly important considerations, chances are, your own estate planning will involve much, much more.

This chapter presents the basics of estate planning that you need to get started on. In this chapter, we show you why estate planning is every bit as important as saving for your child's college education or putting money away for your retirement. In fact, your estate plan is the continuation and culmination of your personal and family financial planning.

What Is an Estate?

In the most casual sense, your estate is your *stuff* (all your possessions). However, even if your only familiarity with estate planning comes from watching a movie or TV show where someone's will is read, you no doubt realize that you aren't very likely to hear words like "I leave all of my stuff to. . . ." Therefore, a bit more detail and formality is in order, which we provide in this section.

The basics: Definitions and terminology

"All my property."

Think of that phrase when you plan your estate.

What's that, you say? You live in an apartment and don't own a house or a condo or any other real estate (more formally known as *real property*; see the "Property types" section, later in this chapter), so you think you don't have any property? Not so fast! In a legal sense, all kinds of items are considered your property, not just real estate, including the following:

- Cash, checking and savings accounts
- Certificates of deposit (CDs)
- Stocks, bonds, and mutual funds
- Crypto assets such as cryptocurrencies and non-fungible tokens (NFTs)
- Retirement savings in your individual retirement account (IRA), 401(k), health savings account (HSA), and other special accounts
- Household furniture (including antiques)
- Clothes
- Vehicles
- Life insurance
- Annuities
- Business interests
- Jewelry, your baseball card collection, that autographed first edition of *The Catcher in the Rye,* and all the rest of your collectibles

As we discuss in the "Property types" section, your estate consists of all the preceding types of items — and even more — divided into several different categories. (For estate-planning purposes, these categories are often treated differently from each other, but we cover that distinction later.)

The types of property listed almost always have a *positive balance*, meaning that they are worth something even if "something" is only a very small amount. Of course, an exception may be your overdrawn checking account, which then is actually property with a negative balance. So, your estate also needs to account for debts that need to be subtracted from your asset values, such as:

- The outstanding balance of the mortgage you owe on your house or a vacation home
- The outstanding balance on all loans (home equity, car, or student loans)
- The outstanding balances on your credit card accounts

» Taxes you owe to the government
» Any IOUs to people that you haven't paid off yet

REMEMBER

Basically, all debts you have are as much a part of your estate as all the positive-balance items.

In addition to understanding what your estate is, you also need to know what your estate is worth. You can calculate your estate's value as follows:

1. **Add up the value of all the positive-balance items in your estate (again, your banking accounts, investments, collectibles, real estate, and so on).**
2. **Subtract the total value of all the negative-balance items (the remaining balance of the mortgage on your home, how much you still owe on your credit cards, and so on) from the total of all the positive-balance items.**

The result is the net value of your estate, which you could think of as your "personal balance sheet." In most cases, the result is a positive number, meaning that what you have is worth more than what you owe.

TECHNICAL STUFF

If calculating a *net value* by subtracting the total of what you owe from the total of what you have seems familiar, you're right! In the simplest sense, calculating the value of your estate involves essentially the same steps that you follow when you apply for many different types of loans (mortgage, automobile, educational assistance, and so on).

WARNING

However, in many cases — including perhaps your own — determining what the parts of your estate are, and what they're worth, can be a bit more complicated than simply creating two columns on a sheet of paper or in your computer's spreadsheet program and doing basic arithmetic. If you're a farmer, for example, you need to figure out the value of your crops or livestock. If you own a small one-person business, you need to calculate what your business is worth. Or perhaps you and six other people are joint owners of a complicated real estate investment partnership; if so, what is your share worth?

In Chapter 2, we discuss more technical and sometimes more complicated ways to determine your estate's value.

For now, another point to keep in mind is that, in addition to what you have right now, your estate may also include other items that you don't have in your possession, but will at some point in the future, such as:

» Any future payments you expect to receive, such as an insurance settlement or the remaining 18 annual payments from that $35 million lottery jackpot that you won a couple of years ago!

THE RIPPLE EFFECT

WARNING

The old saying "Don't count your chickens before they're hatched" can definitely be applied in estate planning as it relates to future inheritances you're supposed to receive and then, in turn, pass on to others as part of your own estate plan.

For example, your grandparents, parents, and other loved ones (your *benefactors*) may have informed you that they have provided you with an inheritance — money, property, or something else of monetary value — in their own estate plans. However, you know how things in life often change. Changes in a benefactor's circumstances, such as a health issue that requires unplanned health-care costs, can easily eat into or even evaporate your inheritance. Accordingly, when it comes to these future inheritances that are eventually supposed to be heading your way, you need to keep the "uncertainty factor" in mind and make adjustments as necessary in your own estate plan. Essentially, unforeseen changes to the estate of one of your own benefactors could "ripple" into unforeseen changes in your own estate.

- A loan you made to your sibling to help get their business started that they will eventually repay.

TIP

For planning purposes, you also want to consider future inheritances you *may* receive, which *might* be part of your estate when you die (see the nearby sidebar, "The ripple effect").

If you're familiar with the business and accounting term *accounts receivable* (what people or businesses owe to you), you need to include your own personal accounts receivable along with your banking accounts and home when figuring out what your estate contains and what your estate is worth.

One final term to cover is *estate planning.* By definition, estate planning means to plan your estate (of course!). More precisely, you need to follow a disciplined set of steps that we discuss later in this chapter. Why? Because you want to protect as much of your estate as possible from being taken away, and because you want to control what happens to your estate after you die. An estate plan allows you to preserve as much as you can for your *beneficiaries* (family members, lifelong friends, or maybe even your favorite charities).

REMEMBER

Your estate plan typically includes the following:

- Your will
- Documents that substitute for your will, called (big surprise) *will substitutes*

- Trusts
- Tax considerations, with the idea of minimizing the overall amount of taxes you have to pay
- Various types of insurance, such as life insurance and long-term care insurance
- Items related to your own particular circumstances, such as protecting your business or setting aside money to pay for your health care or a nursing home in your later years

All these aspects of estate planning are discussed in this book. If this collection of estate-planning activities seems a bit overwhelming, think of estate planning as a parallel to how you plan your personal finances and investments. Your investment portfolio may be made up of individual stocks, bonds, mutual funds, and exchange-traded funds (ETFs), along with bank CDs or other savings-related investments. And then, within each type of investment, you have further categories (for example, different types of mutual funds) that you may want to use.

Your investment objective is to sort through this menu of choices and put together just the right collection for your needs. You must also do the same with your estate plan. You need to have the right will and insurance coverage, possibly accompanied by trusts if they make sense for you and your family (see Chapter 7). You may need additional estate-planning activities and strategies particular to your own needs.

Property types

You can have several types of property within your estate. Make a distinction between these types of property because various aspects of your estate planning treat each type differently. For example, in your will (see Chapter 3), you can use different legal language when referring to various types of property, so remember to keep these definitions and distinctions straight!

Earlier, we mention one type of property — *real property* — and note that real property refers to various types of real estate, including the following:

- Your *home* (a house, condominium, co-op apartment, or some other type of primary residence that you own)
- A second home (such as a vacation property on a lake or near a ski resort)

- A "piece" of a vacation home, such as a time-share
- Fractional ownership in real estate (through companies such as Pacaso and Arrived)
- Any kind of vacant land, such as a building lot in a suburban development or even agricultural land you may own next to your "main" farm
- Any investment real property that you own either by yourself or with someone else, such as a house you rent out through Airbnb or Vrbo or on your own, or your share of an apartment building

TECHNICAL STUFF

In addition to the actual real property itself, your estate also includes any improvements that you can't even see. For example, if you and three of your friends bought 200 acres of land with the intention of turning that land into a subdivision, and you've spent loads of money on infrastructure — water lines and hookups, sewer lines and hookups, in-ground electricity and cable, and so on — then those improvements (or, more accurately, your share of those improvements) are also considered to be part of your estate along with the original real property itself.

In addition to real property, your estate includes *personal property*, which is further divided into two categories:

- **Tangible personal property:** Your tangible personal property includes possessions that you can touch, such as your car, jewelry, furniture, paintings and artwork, and collectibles (baseball and sports cards, autographed first-edition novels, and so on).

  REMEMBER

  Your house is considered to be real property, not tangible personal property, even though you can touch it. Why? Because your house is permanently attached to (and, thus, made a part of) the land upon which it is built.
- **Intangible personal property:** Your intangible personal property consists of financially oriented assets, such as your bank accounts, stocks, mutual funds, bonds, and your IRA.

TECHNICAL STUFF

Technically, that stock certificate or mutual fund statement isn't actually what you own; it represents your portion of the ownership of some company (in the case of the stock certificate) or your portion of that mutual fund in the companies' stocks in which it invests. Sound confusing? Don't worry — just keep in mind that financially oriented paper assets are typically intangible personal property, while actual possessions are tangible personal property. If you have any doubt as to what category any particular item of your possessions falls into, just ask one of your estate-planning team members.

ARE NFTs REAL, TANGIBLE, OR INTANGIBLE?

What about those trendy yet sometimes perplexing *non-fungible tokens,* or NFTs? Aren't NFTs imaginary? After all, a digital image of a baseball card or a bored ape isn't really a physical baseball card or an actual piece of artwork featuring that really popular bored ape. Essentially, you have sort of a "receipt" recorded on a digital ledger — called a *blockchain* — that tells the world that you own that image.

Still, for estate-planning purposes, you can think of an NFT as just one more type of intangible personal property. In fact, you can draw a parallel between an NFT and the way you would own today, say, 100 shares of Tesla stock. You no longer have a physical stock certificate featuring elegant lettering stating that you own those Tesla shares. Instead, your Tesla shares are electronically recorded out in cyberspace.

You'll find some differences between how your Tesla shares are recorded versus how your ownership of an NFT is established. Most likely, your ownership of stocks, bonds, and mutual fund shares are recorded in some type of traditional database, whereas NFTs are part of the world of blockchains and cryptocurrency. However, the movement toward the so-called "Web 3.0" could eventually provide a blockchain underpinning for your stocks, bonds, and mutual funds, just like your NFTs.

The good news, though, is that for estate-planning purposes, you don't need to worry about blockchains and Web 3.0 and all that — you only need to know that if you jumped into the NFT game, you would treat those NFTs that you own as *intangible* personal property rather than real property.

Types of property interest

For each of the three types of property in your estate — real, tangible personal, and intangible personal — you also need to understand what your interest is.

"Of course, I'm interested in my property," you may be thinking. "After all, it's *my* property, isn't it?"

In the world of estate planning, *interest* has a somewhat different definition than how that word is used in everyday language, or even as the word is often used in the financial world (for example, interest that you earn on a CD or pay on a loan). And more important, the specific type of interest in any given property determines what you specifically need to be concerned about for your estate planning.

Property interest is an essential part of almost all your estate planning, from the words that you put in your will (Chapters 3 through 6) to how you may set up a trust (Chapter 7), for two very important reasons:

- You need to clearly understand what type of interest you have in your property, so you can make accurate decisions about how to handle your property when you plan your estate.
- As you decide what to write in your will and perhaps also set up trusts as part of your estate plan, you need to make decisions about what type of interest in each property that you want to set up for your children, your spouse, other family members, or institutions such as charities.

The two main types of property interest are

- Legal interest
- Beneficial interest

If you only have a *legal interest* in a property, you have the right to transfer or manage that property but you don't have the right to use the property yourself. For example, Part 3 of this book discusses the very important (and very complicated) subject of trusts that may be an essential part of your estate planning. By way of a very brief introduction to that topic, when you set up a trust you name a *trustee* (a person who manages the trust).

Suppose you set up a trust for your oldest son, Alvin, as part of your estate plan, and you name your aunt, Jackie, as the trustee. Jackie isn't allowed to use Alvin's trust for her own benefit, such as withdrawing $10,000 for a trip to Paris. That's called "Aunt Jackie goes to jail for stealing!" Assuming Jackie does what she's supposed to do — and, more important, doesn't do what she's *not* supposed to do — Jackie has a legal interest in Alvin's trust as the trustee.

Unlike Aunt Jackie, Alvin has the other type of property interest in his trust: a *beneficial interest*, meaning that he *does* benefit from that trust. Basically, you set up that trust to benefit Alvin.

Now, to complicate matters a bit more, two "subtypes" of beneficial interest exist:

- Present interest
- Future interest

If you have a *present interest* (remember that means "present beneficial interest") you have the right to use the property immediately. So, if Alvin has a present interest in his trust that is managed by Aunt Jackie, he may receive payments of some specified amount — for example, $30,000 every three months — from the trust. After Alvin receives the money, he can do whatever he wants with it; the money is his to use, no strings attached.

The other type of beneficial interest — *future interest* — comes into play when someone with a beneficial interest (that person is allowed to benefit from the property) can't benefit right now, but instead must wait for some date in the future.

For example, you can set up the trust described to not only benefit Alvin, but also benefit your other two sons, Simon and Theodore. But you decide to take care of your three sons differently within that same trust. Suppose that after Alvin receives his quarterly $30,000 payments for five years, his payments will then stop, and Simon and Theodore will each begin receiving $30,000 quarterly payments. Essentially, Simon and Theodore have a future interest in the property (the trust) because they can't benefit right now; instead, they benefit in the future.

Complicating factors just a bit more (last time, we promise!), someone with a future interest in property can actually have one of two different types of future interest:

- Vested interest
- Contingent interest

If you have a *vested interest,* you have the right to use and enjoy what you will get from that property at some point in the future, with no strings attached.

TECHNICAL STUFF

In the world of estate planning, the word *vested* means basically the same as it does in the world of retirement plans, stock options, and other financial assets. After you're vested in your company's retirement plan, you have the right to receive retirement benefits according to the particulars of your company's plan, even if you leave your job (unless you worked at Enron, but that's another story . . .). Similarly, if you have stock options that have vested, you have the right to "exercise" those options and buy your company's stock at your "strike price." Furthermore, if you want, you can immediately sell those shares for a quick profit if your company's stock price has gone way up (unless you worked at Enron, but that's basically the same story . . .).

However, if you have the other type of future beneficial interest — *contingent* — then you have to deal with some strings attached other than the simple passage of time. For example, you may set up that trust for your three sons in such a way that for Simon and Theodore to *realize* that future benefit, each must graduate from college and spend two years in the Peace Corps.

Why You Need to Plan Your Estate

You can, of course, decide to leave what happens to your estate after you die totally up to chance (or, more accurately, the complicated set of state laws that will apply if you haven't done the estate planning that you need to do). But because you're reading this book, chances are, the two fundamental goals of estate planning at the beginning of this chapter — protection and control — are uppermost in your mind.

But going beyond the general idea of protecting your possessions and being in control, you have some very specific objectives that you're trying to accomplish with your estate planning, such as the following:

- **Providing for your loved ones:** You have people like your spouse or significant other, children, grandchildren, and parents who may rely on you for financial support. What would happen to that financial support if you were to die tomorrow?

  WARNING

  Even if you have a "traditional" family (that is, the kind of family typically shown in a 1950s sitcom), financial and other support for family members after you die can get very complicated if your estate isn't in order. But if your family isn't exactly like the one in *Leave It to Beaver,* then you absolutely need to pay attention to all the little details of protecting your family members if you die. Specifically, if your loved ones include former spouses, children living in another household, stepchildren, adopted children, divorced and remarried parents, or an unmarried partner, then you have a lot of decisions to make with regard to your estate and who gets what.

- **Minimizing what your estate will have to pay in estate taxes:** Yes, we know that we said that estate planning involves much more than the inheritance and estate (death) taxes, but make no mistake about it, death taxes are certainly a consideration. Why pay more than you have to? You can take several steps — such as giving gifts while you're still alive (see Chapter 2) — to reduce the value of your estate and, therefore, reduce the amount of death taxes that will have to be paid.
- **Protecting your business:** Politicians love to talk about the small business owner or the family farmer when describing how they're "a friend to the little guy," but the fact remains that if you own a small or medium-size business, such as a retail store or a farm, that business can be turned topsy-turvy if you die without a solid estate plan in place.

Sure, it's human nature to just let things happen. You're very busy with your career and your family. And after all, do you really want to dwell on morbid thoughts such as your own death?

But you really can't take any of your property with you, and you do leave behind people and institutions (charities, foundations, and so on) that you care about along with all your possessions. So, why wouldn't you want to take the time to appropriately match up your property with those people and institutions?

Besides, estate planning is as much about what you do during your life to manage your estate than what happens after you die. Sure, it makes good theater to have a deathbed scene where the aged family patriarch or matriarch dictates what will happen to the vast family fortune, but the place to begin your estate planning isn't on your deathbed! That last-minute approach usually opens up the probability of one or more disgruntled family members trying to overturn your dying words. More than likely, due to the result of your lack of estate planning, your estate will dwindle away through legal fees and taxes in excess of what should have been paid.

And not to be morbid, but if you were to die suddenly and unexpectedly, you may not even have the "opportunity" for that dramatic deathbed scene. If you haven't done your estate planning, chances are, nobody in your family will have any idea what you want to happen to your estate.

Need more? How about the game that the United States Congress is playing with the federal estate tax? As part of the estate tax laws (discussed in Chapter 13), you have an *exclusion* — an amount that you may leave behind that is free of the federal estate tax. (The estate tax doesn't kick in until your estate exceeds the exclusion amount).

When the first edition of this book was published back in 2003, the federal estate tax exclusion had just been set at $1 million. In 2022, however, the estate tax exclusion (the amount of your estate that is protected from being taxed by the federal government) was much, much higher: $12.06 million for an individual and $24.12 million for a married couple! Even better, the estate tax exclusion will continue to increase indexed to inflation until 2026. And given the resurgence of inflation in the early 2020s, that annual exclusion increase will really help you out when it comes to protecting your estate from inflation.

WARNING

Beware though! In 2027, the *sunset* (a commonly used legal and financial term meaning "the end or expiration") of the Tax Cuts and Job Act of 2017 will cut those personal and married exclusions by a gigantic 50 percent — or even more because of indexing.

This means that an estate that escapes taxes in 2026 because of the generous exclusion could find itself whacked by estate taxes in 2027. But wait, there's more.

In general, estate taxes are an important part of crafting your overall estate plan. But why should you care if your estate value is far below these exclusions? Well, just because the value of your estate is less than the federal tax exclusion levels *now*, or even after the 50 percent cut in 2027, that doesn't mean it always will be. Federal estate tax exclusions are a popular tax issue used as talking points by both Congress and the president as a way to increase tax revenue and make the "wealthy" pay their fair share.

TECHNICAL STUFF

A historical look at some of the estate tax exclusions over the last 20 years highlights that estate tax exclusion amounts are a moving target:

- $1 million in 2003
- $1.5 million in 2005
- $2 million in 2008
- $3.5 million in 2009
- $5 million in 2010

At first glance, it seems that the federal tax exclusions only increase — great news, right? — but the drumbeat continues in Washington to "roll back" these exclusions to much lower numbers. Do we hear $1 million? This is why estate taxes in general, and exclusion amounts in particular, matter so much and why you need to keep an eye on the current exclusions and changes to these exclusion amounts by Congress so you can adjust your estate plan for tax-planning purposes. Suppose your estate is, indeed, subject to federal estate tax; the maximum 2022 estate tax rate is 40 percent. Ouch!

We spend much more time on Congress's little game and what that means to your estate planning in Chapter 13. The main point for now is that for federal estate-tax purposes, your estate planning is actually a moving target between now and 2027. If you were to die between now (the time you're reading these words) and 2027, the amount of federal estate tax could be all over the map if your estate is very valuable. Now, most people won't try to work "Dying in a specific year" into their estate plans for the sole purpose of saving money on federal estate taxes. But the point is that you really need to stay on top of your estate-planning activities to try to minimize the amount of those taxes.

TIP

Another reason to plan your estate has to do with a mistake that many married couples make with their respective estates. Irrespective of the federal estate tax and varying exclusion amounts, you can leave an unlimited amount of your estate to your spouse free of federal estate taxes.

WARNING

However, sometimes you're better off *not* leaving your entire estate to your spouse, especially if your spouse also has a sizable estate (not only property jointly owned with you, but personal property that only your spouse owns). Why? Because then your spouse (assuming you die first) now has an even *larger* estate, which is then subject to a potentially larger tax liability than if you had done something else with your estate. Basically, your children or whoever else you and your spouse are leaving your respective estates to will likely be stuck paying more in federal estate taxes just because you decided to take the easy step with your estate and leave it all to your spouse.

Many states also impose inheritance and estate taxes that your estate pays in addition to federal estate taxes (see Chapter 10).

The answer? You need to proactively conduct your estate planning, take all the matters in this section into consideration, and create a personalized estate plan.

Why Your Estate-Planning Goals Are Different from Your Neighbor's

You are unique.

No, the above statement isn't part of the latest feel-good pop psychology designed to boost your self-esteem. Instead, it's a point we want to emphasize to stress why you need to take time to create an individualized estate plan for your own situation. Your financial plan and retirement plans are specific to *your* individual circumstances and needs, right? Well, your estate plan is no different.

Many people finally and grudgingly acknowledge that they need to worry about their estate plans but then take a haphazard, lackadaisical approach to estate planning: a generic fill-in-the-blank will purchased in a stationery store, a cursory review of active insurance policies, and checking to see whose names are listed as beneficiaries on the retirement plan at work. But that's all — everything else will fall into place, right?

And besides, is it really worth putting in any more time and effort beyond those basic tasks? After all, you'll be dead. Why make all that effort for a series of events that will take place after you're gone?

But consider all the factors that make up many different aspects of your life, including the following:

- Your marital status (married, divorced, separated, single, widowed, or unmarried but living with someone).
- Your age.

- Your health. (Not to be excessively morbid, but if you know that you have a potentially fatal illness, or you're in generally poor health, time is of the essence for your estate planning.)
- Your *financial profile,* such as the property (real and personal) you have and what that property is worth.
- Any potentially complicated business or financial situations you have, such as investment partnerships.
- Any money you expect to receive — particularly large sums — such as an inheritance, lawsuit settlement, or severance pay from a job you're leaving.
- What insurance policies you have, the types of insurance (see Chapter 17), and the value of each.
- If any of your assets are particularly risky, such as stock or stock options in a start-up company that, on paper, is worth millions of dollars, but you can't do anything with those assets for some reason (for example, maybe your stock options haven't fully vested).
- If you have children and, if so, how many, their ages, their respective financial states, and their respective marital statuses.
- If you have any grandchildren and, if so, if you want to explicitly take care of them as part of your estate planning or, alternatively, leave it to your children to take care of their own children as part of their own estate planning.
- If your parents are still alive and, if so, whether they're still married to each other, if either may have remarried, their financial status (together or, if divorced, separately), and if you need to take care of them.
- Your siblings and if you want or need to take care of them as part of your estate planning.
- Any other family members (cousins, aunts, uncles, and so on) or even friends that you want to include in your estate planning.
- Charities and foundations that you support.

Just consider the items in this list — not to mention dozens of others that you can probably think of — and the answers for you and your life. Sure, somewhere in the United States, you can probably find someone else with more or less the same profile as yours, but the point is that no estate plan is a one-size-fits-all plan that you can effortlessly adapt to your situation.

Additionally, even a canned plan that seems to be suitable for your situation may actually be a poor choice after you really dig into the details. Think of the outfit that looks great in an ad but, when you try it on, something just doesn't look or feel right.

REMEMBER

We strongly recommend that you make your credo for estate planning "No shortcuts allowed!" The time, effort, and even expense that you put into developing a solid, comprehensive estate plan will be well rewarded. True, you won't necessarily be alive to fully see the benefits of your efforts, but those people who you care about enough to include in your estate plan likely will be grateful!

Why Estate-Planning Lingo Isn't Really a Foreign Language

Part of the reason many people shy away from doing the proper amount of estate planning is because of the many different disciplines involved, including law, accounting, personal finance and investments, and insurance. And with each of those disciplines comes an entire set of complicated terminology — some more complicated than others, such as the many legal terms that come into play.

Abatement statue. Antilapse statute. Exordium clause. Inter-vivos trusts. Uniform probate code. The technical terms go on and on and on.

And you thought cryptocurrency lingo was confusing? But instead of throwing your hands up in disgust, we suggest the following plan of attack to get through the complicated terminology.

Even though we use and explain many different technical estate-planning terms throughout this book, we also provide plain-language alternative definitions. For example, in Chapter 3, we discuss the *exordium clause* of your will, but we suggest that you think of that clause as the introductory clause because the clause is your will's introduction.

You're more than welcome to try to remember all the Latin-root legal terms that we use when discussing wills, trusts, and the other topics, but if you're more comfortable with plain-language definitions, use the easier definitions instead. Leave the legal-speak and technical terms to the estate-planning team members who we discuss later in this chapter.

REMEMBER

Don't worry about being overwhelmed by estate-planning legal definitions. It's more important to understand the concepts than worry about learning legal jargon. If you're working with a good estate-planning team, your attorney can handle all the legalese and make sure all your estate documents reflect the proper clauses and conditions, which, in turn, reflect your wishes for your estate.

The Critical Path Method to Planning Your Estate

Estate planning is a process that can be further divided into multiple steps or activities. Whether in business or in life itself (planning a wedding, for example), most processes tend to take days, weeks, months, or even years from start to finish; rarely does any process happen overnight. All these things take planning.

You need to treat your estate-planning activities as a process. The process includes a disciplined method created from a set of steps that lead you from a state of *estate-planning nothingness* (that is, you have no estate plan at all) to the point where you have a well-thought-out estate plan in place. We recommend using the *critical path method* to planning your estate.

TECHNICAL STUFF

If you've taken a college business class in operations research, quantitative methods, or a similar topic, you may already be familiar with the critical path method, which is defined as "the most effective way through a series of steps to reach your objectives." In other words, even when you have a seemingly infinite number of possible paths in front of you, you can find one particular path that is the most effective and efficient of all those alternatives.

In estate planning, you're often faced with many side roads when working on your will or setting up a trust. Before you know it, the side road has turned into a detour and your estate plan is in a state equivalent to your car being stuck up to its lug nuts in mud. (If you're automotively challenged, the previous sentence means you aren't going anywhere anytime soon.)

TIP

If the terms *operations research* and *quantitative methods* cause shudders and tremors as you flash back to college courses that you barely passed, simply think of the critical path method as a map. If you're standing on a corner in Winslow, Arizona, and you want to go to Phoenix, Arizona, you can get in your car and, after checking a map, drive approximately 190 miles of interstate highway. Or maybe you don't know the area very well and you're one of those people who never checks a map, so you get in your car and just start driving. First, you head to Los Angeles, then you drive up to San Francisco, then maybe you go over to Chicago, then back to Denver, and then you drive toward Phoenix. ("By the time I get to Phoenix, she'll be on Social Security.")

Anyway, the critical path method is fairly straightforward and includes the following steps:

1. **Define your goals.**

   Before you begin your estate planning, decide what you're trying to achieve. Are you trying to make sure that your spouse has enough income for some period of time (say, five years, or maybe longer) if you were to die suddenly? Are you trying to make sure that your children have enough money for college after you're gone? Is your estate worth upwards of $10 million, and are you trying to protect as much as possible from the eventual federal estate-tax bite?

As we mention earlier in this chapter, your estate-planning goals are almost certainly different from anyone else's, so make sure you take the time to define exactly what those goals are.

TIP

Write down your goals — don't just think about them. Often by actually writing your goals rather than just visualizing them, you get a better handle on how your goals relate to one another, and you make sure that you haven't forgotten anything.

2. **Determine which estate-planning professionals you want to work with.**

   Financial planners, insurance agents, attorneys, and accountants (all of whom we discuss in the next section) can provide valuable guidance and service to you. You need to determine which professionals best help you meet your goals. For example, have an attorney work with you on your will to be sure you meet all your own state's requirements for the will to be legally binding. You may also decide to work with other professionals depending on the complexity of your estate and the particular goals you defined in the previous step.

3. **Gather information.**

   Whether you work with professionals or not (more on this particular decision point in the next section), you need to have as much available information as possible so you know where you are currently in your estate-planning process. You need to ask yourself the following questions:

   1. Do you have a will right now and, if so, when did you prepare that will?
   2. What in your life has changed since you created that will?
   3. What insurance policies do you currently have?
   4. Have any insurance policies expired?
   5. Perhaps most important, what property is in your estate and what is the value of that property?

4. **Develop your action plan.**

   Basically, get ready to do the many different activities we discuss in this book: Work on your will (create your will if you don't have one, or perhaps update your will if the will is out of date); decide if trusts make sense for you and, if so, choose which ones; figure out what you need to do to protect your business; and so on.

5. **Actually conduct your action plan.**

   People often trip up on this step during their estate planning (or anything else they like to procrastinate on). Take the plans that you developed in Step 4 and actually do them! If you die without a will, complications may arise even if someone in your family finds a sheet of paper on your desk that reads "Step 4: Prepare my will."

6. **Monitor your action plan.**

   You may like going through all the previous estate-planning steps, finishing them, and then just forgetting about them all. But in estate planning, you never really finish. You periodically need to resynchronize your estate plan with any major changes in your life. For example, have you gotten divorced and remarried? You'd better get cracking on those updates! Even less dramatic changes in your life can trigger changes, so your best bet is to double-check everything in your estate plan once a year so you can make sure that all changes to your life, great and small, are reflected in your estate planning in a timely fashion.

   TIP

   You can even tie your "checkup" to an annual occurrence, like your birthday, or the first of the year, or to some other occasion that you won't easily forget. Just add a recurring calendar reminder to your calendar app so you remember.

By following these steps and staying on the critical path, you greatly reduce the chances of taking all kinds of unnecessary and potentially serious detours with your estate planning, and you can typically get through the tasks with a minimum amount of stress.

TIP

Take the initiative to meet with each member of your estate-planning team annually. Or ask someone on the team to remind you annually to review your estate plans — the way your dentist reminds you to come in for a checkup.

Getting Help with Your Estate Planning

You can do all your estate planning by yourself, but you don't have to and, even more important, we don't recommend that approach. But can you turn to someone with a job title along the lines of *professional estate planner* for help?

Not exactly. As we mention several times in this chapter, estate planning actually consists of several different specialties or disciplines, and if you want, you can work with one or more people in each of those specialties as part of your estate planning.

The number of people with whom you work largely depends on two main factors:

- How comfortable you are with the overall concepts and mechanics of estate planning
- How complicated your estate is

The material covered in this book can go a long way toward helping you with the first of those two factors. But even if you thoroughly understand little nuances of the clauses to include in your will (see Chapter 3) or the basic types of trusts (see Chapter 7), you may still want to tap into a network of professionals if your estate is particularly complicated. Sure, you'll spend a bit more money on fees, but in the long run, you're more likely to avoid a horrendously costly mistake (financially, emotionally, or both), particularly if your estate is rather complicated.

How to make sure your team of advisers is "FAIL" safe

So, who do you work with? Here's an acronym to help you remember who you need to think about for your estate-planning team: FAIL, which stands for:

- Financial planner
- Accountant
- Insurance agent
- Lawyer

The order of the professionals in this list doesn't indicate any type of priority (that is, your financial planner isn't more important than your accountant) or any type of sequence (such as you must work with your accountant before you work with your insurance agent). The order shown is solely for the purposes of the FAIL acronym to help you remember these different professions and how they may help you.

TIP

You don't necessarily need a full slate of estate-planning professionals on your team. You may, for example, work with your lawyer and accountant. But if you've decided that insurance is only a minimal part of your overall estate plan, then you may not need to work with an insurance agent. Or if you're well versed in investments and financial planning, then you can handle that aspect of your estate plan by yourself and work with team members from the other specialization areas.

STRAIGHT TALK

You need to talk candidly and honestly about personal and sometimes sensitive — or even painful — matters with your estate-planning team. The last thing you want is for your insurance agent to recommend a certain type of insurance policy that the issuing insurance company could invalidate because you hid some important fact that was later found out. And your lawyer needs to thoroughly understand all aspects of your relationships with your family to help you create a will that accurately reflects your wishes. For example, if you really want to cut someone out of your will and leave that person nothing at all, make sure that your lawyer knows that so your will can be constructed appropriately.

WARNING

The best professionals sometimes set things into motion that can have unintentional and less-than-desirable consequences if another member of your estate-planning team isn't aware of what was done. For example, you need to be certain that you understand all the tax implications — federal income, state income, gift, estate, and so on — of a trust that your financial planner recommends and that your attorney sets up. Therefore, your accountant needs to work side-by-side with your lawyer and your financial planner before the trust is created to be sure that no unpleasant tax surprises pop up.

Working with a financial-planning professional

Because a significant portion of your estate is likely to involve your investments and savings, consider working with some type of financial-planning professional. You can work with a financial-planning professional solely on an advisory basis. If you want, you can make your own decisions about your investments and savings, after consulting with a professional. Your financial-planning professional also can play a much more active role, such as making major decisions for your financial life (with your consent, of course).

WARNING

All financial-planning professionals aren't created equal, nor do they necessarily have the same background and qualifications. In the following paragraphs, we provide a brief overview, and you can also find a very candid, no-holds-barred discussion of financial planners in *Personal Finance For Dummies* by Eric Tyson (Wiley).

Before you decide to work with any financial-planning professional, you need to understand just who these people are, what type of formal training and credentials they have, and how using them relates to your estate planning.

OTHER FINANCIAL-PLANNING PROFESSIONALS

If your financial life is particularly complicated, you may need to work with several types of financial-planning professionals in addition to a basic financial planner (who may or may not be a CFP).

Another type of financial-planning professional is the *investment adviser* (IA) or the *registered investment adviser* (RIA). IAs and RIAs specifically advise their clients about securities (stocks, bonds, and so on). Any IA who manages at least $25 million in assets must register with the Securities and Exchange Commission (SEC), and you can check this information out at `https://adviserinfo.sec.gov`.

Chartered Financial Analysts (CFAs) are typically portfolio managers or analysts for banks, mutual funds, or other institutional clients (in Wall Street lingo), but some CFAs also advise wealthy individuals and families who have particularly complicated investment situations. CFAs take a series of examinations covering portfolio management, accounting, equity analysis, and other subjects, and must have at least three years of professional experience in investments. CFAs are also required to sign an ethics pledge every year.

A *Certified Fund Specialist* (CFS) works with clients on mutual funds. (Some CFSs also provide general financial-planning services.) Examinations and continuing education are required to retain CFS status.

Certified Financial Planners (CFPs) provide financial-planning services and general financial advice on a wide range of topics from investments to taxes and from estate planning to retirement planning. CFPs are required to pass college-level courses in a broad range of financial subjects and then a two-day, ten-hour examination. CFPs must also have a bachelor's degree and at least three years of professional experience working with financial-planning clients *or*, without a degree, they must have at least five years of experience doing financial planning.

TIP

You can check with the Financial Planning Association at `www.financialplanningassociation.org` and search for planners by state, city, or zip code. You can find financial planners who have the CFP credentials. You can then verify a planner's CFP status with the CFP Board of Standards at `www.letsmakeaplan.org`. Just enter your location, and the site gives you not just names, but also the specific services they offer — estate planning, tax planning, insurance planning, and so on.

You can regularly check *Money* (`https://money.com`), *Kiplinger* (`www.kiplinger.com`), and other personal finance publications for the latest information, and even problems and scandals in the profession. Searching online reviews for someone you're thinking about working with is a good way to get an overall consensus about the good, and less good, points about working with a specific financial professional.

WARNING

Make sure you clearly understand how your financial-planning professional — CFP or otherwise — gets paid! Some financial-planning professionals get paid on a "fee-only" basis, meaning that they don't receive any commissions for selling you financial products. They're only compensated for advice (basically, they're consultants).

Fee-based financial-planning professionals earn fees not only from the advice they give you, but also from commissions for selling you financial products, while commission-based financial-planning professionals only make money from the products they sell you.

You can certainly find both ethical and unethical people (not to mention competent and incompetent) in either of these categories. However, always pay particular attention to recommendations from fee-based or commission-based financial-planning professionals. Perhaps those investment choices are the perfect match for you, but you need to make that decision, not your financial-planning professional who stands to benefit financially from selling you some type of product.

Knowing what to expect from your accountant for your estate planning

Your accountant can do a lot more for you than fill out your tax returns for the previous year. Businesses use accountants for planning purposes — trying to steer what happens in the future for tax purposes by doing certain steps today. You can work with an accountant on your estate planning for those very same reasons, even if you do your own income taxes and haven't really worked with an accountant before.

Make sure the accountant on your estate-planning team presents you with scenarios of what will likely happen, based on recommendations from other members of your estate-planning team. If your CFP recommends certain investments or insurance products, then what are the tax implications when you die? What are the tax implications if you die tomorrow versus dying ten years from now?

Your accountant can also play a more active role in your estate planning, suggesting certain tactics with an eye toward reducing your overall estate-tax burden, giving gifts in particular.

WARNING

Never do any financial gift giving (as contrasted with birthday gift giving or holiday gift giving) without consulting with an accountant for all the tax implications (see Chapter 11 for details of financial gifts and the gift tax).

Seek out an accountant who is a Certified Public Accountant (CPA), meaning that the accountant has passed the American Institute of Certified Public Accountants (AICPA) examination.

TIP

You may also consider combining two of the roles on your estate-planning team — the financial-planning and accounting specialists — by working with someone who is a Certified Public Accountant/Personal Financial Specialist (CPA/PFS). In other words, find a CPA who also provides overall financial planning and has passed the PFS exam.

Your insurance agent and your estate

Depending on your particular estate-planning needs, various forms of insurance (life, disability, liability, and other types we discuss in Chapter 17) may play a key role. Most people who have dependents (particularly a spouse and children) wind up working insurance into their estate plan to meet the "protection" objective of estate planning.

So, consider your insurance agent a part of your estate-planning team. For example, when you discuss life insurance and choose among different types of life insurance policies (see Chapter 17), make sure that your insurance agent is aware of any estate-planning strategies, such as trusts, so you can make sure that your policy beneficiaries are listed correctly.

TIP

Some insurance companies are *agentless,* meaning that, unlike traditional insurance companies, where you have an assigned insurance agent, your contact with the company is through any one of hundreds or even thousands of customer service representatives, almost always over the phone or online. In these situations, ask one of the customer service representatives whether you can speak with or even work with anyone at the company on estate-planning matters. Chances are, the representative will say yes, so even though you don't technically have an insurance agent, you may still have access to short-term estate-planning assistance when you need it.

Working with your attorney

Even though your attorney is last on the list of the members of your estate-planning team (courtesy of the *L* for *lawyer* that we use in our *FAIL* acronym), they could quite possibly be the most important member for one simple reason: Your attorney keeps you from inadvertently making very serious mistakes!

All kinds of problems can trip you up and cause serious headaches in the future (if not headaches for *you*, because you've already died, then headaches for someone you care about). For example:

- How should your will read to make sure that your significant other (to whom you are not married) receives what you want out of your estate?
- How should the deed to your home be written to make sure that your unmarried significant other isn't forced to move if you die first?
- If you have an elderly parent who needs to go into a nursing home, what are the implications to your parent's estate and your own?

Basically, think of your attorney as your scenario-planning specialist. Your attorney takes all kinds of information about you and your estate into consideration. They then present you with options, based on various scenarios, such as your dying suddenly next week (morbid, but definitely an eye-opener for many people when first doing their estate planning) versus your dying at the ripe old age of 134 (courtesy of advanced biotechnology), having outlived everyone else in your family.

Beyond the scenario planning, make your attorney your primary adviser for your will, trusts, legal implications for your business, and pretty much any other legal matter that directly or indirectly relates to your estate planning.

IN THIS CHAPTER

» Tallying up the value of your real estate assets

» Valuing those collectibles and the family silver

» Making sure to factor what you owe into your calculations

» Reducing and controlling your estate's value through gift giving

» Updating your estate planning to reflect changing asset values

Chapter 2
Bean Counting: Figuring Out What You're Worth

Quick: How much are you worth? Or, to ask that question in the context of estate planning: What is the value of your estate?

You may think that you have a pretty good idea of what your estate is worth — within 5 percent to 10 percent, give or take — but you may be very surprised when you actually sit down and start taking inventory of your assets.

If you've ever filled out a loan application for a new car or a home mortgage, chances are, when you began listing your assets, you probably didn't think beyond just your bank accounts, stocks and bonds, mutual funds, and real estate. That somewhat constrained and limited thinking about your assets made sense for the purposes of applying for a big-ticket loan, because those are the assets that lenders typically focus on.

But when it comes to estate planning and making an inventory of your assets, you need to think more broadly. What about that wardrobe of $5,000 custom suits from Italy? And how about all those antiques from trips to Europe? Even families with more modest tastes usually have the family silverware, jewelry, household appliances and furniture, electronics, collectibles, and several other items that add up to a decent amount of money.

TECHNICAL STUFF

During the COVID-19 pandemic, many of these "other" assets actually increased dramatically in value. If you have your childhood collection of baseball cards or other collectibles stashed away in your attic or basement, congratulations! Those assets are probably worth much more than they were at the beginning of the pandemic. And when it came to even more dramatic increases in the value of your house or investment real estate: Wow!

Therefore, to be accurate in your estate planning, you need to know how much your entire estate is really worth at any given point in time. No, you don't need a real-time tracker with daily updates on every asset that's part of your estate. But you can't just do a one-time tally when you start your estate planning and then figure that you're done forever — or maybe for a decade or more.

REMEMBER

On a regular basis (at least annually, and preferably twice a year), take a fresh look at all your assets and not only update their values as part of your financial planning, but also take stock of how any significant changes in value may impact your estate planning.

If you're like most people, you need to dig beneath the surface and beyond the obvious — factoring in your debts and the future, too. In this chapter, we tell you how.

Calculating the Value of Your Real Property

Your *real property* (your home and other real estate–related investments) may very well be the most valuable part of your estate. You need to carefully determine the value of all real property, especially if your estate plans call for dividing the value of that real property among more than one beneficiary. You want to be fair, and you want to have a good idea of what each beneficiary will receive, particularly if some beneficiaries will get other (non-real property) parts of your estate and you're trying to divide your overall estate as equally as possible.

Your home on the range

If you recently purchased your home (say, within the last three years), you have a pretty good idea of your home's worth, even if you live in an area where real estate prices are rapidly going up.

However, if you purchased your home a long time ago, you may have no idea of your property's value. For example, maybe you never purchased your home at all — perhaps you're living in the ancestral home that's been in your family since the early 1900s.

Either way, you need to get an official idea of your home's value, and you can do so in one of two ways:

- **You can hire a real estate appraiser who specializes in the nuts and bolts of determining property values.** A paid appraiser is likely to give you the most thorough and accurate idea of your home's value because you pay for that service.
- **You can do what real estate professionals call "checking comparables.** Find the sale price of a comparable property in or near your neighborhood with a similar floor plan, a similar exterior design, roughly the same lot size, and other characteristics nearly identical to your home. Check out at least a few sites, such as Realtor.com (`www.realtor.com`), Trulia (`www.trulia.com`), Zillow (`www.zillow.com`), and others. Valuations for the same property often vary from one real estate listing website to another, so you may want to take an average from three or even four sites.

WARNING

In most suburban settings, prices and values for nearly identical properties can vary widely depending on what neighborhood the house is in, even if those neighborhoods are right next to each other! So, make sure that if you decide to determine your home's value based on comparable properties yourself, you understand the differences in property values between popular, highly coveted neighborhoods and others not quite so prestigious.

If you live in a home that's unique in any way — a farmhouse set on hundreds of acres or a 200-year-old brownstone in a downtown neighborhood, for example — you should definitely hire an appraiser. Otherwise, you can be way off in determining what your home is worth.

That timeshare in Timbuktu and other hideaways

If you own a second home of any kind, or perhaps a *fractional share* (partial ownership percentage, maybe as a traditional *time-share* or one of the newer fractional ownership models) of a second home, from that beachfront bungalow to a condominium at the foot of a prestigious ski resort, you can figure out what that property is worth in much the same way as you do your primary home.

Your investments as a landlord

If you have any investment real property, such as a rental duplex or a share of an apartment building or office complex, you probably have some background in how to value residential or commercial real estate. (At least you should, because you had to decide whether the investment you were considering making was a good deal.)

TIP

If you do your own finances for your real estate investments, you're familiar with terms like *net operating income* and *capitalization rate*, which are used to calculate how much your investment is worth. But if you don't do your own finances for your real estate investments, don't worry. Whoever manages your investment for you knows these terms, so just ask your investment manager how much your investment is worth. If, however, you invested $50,000 ten years ago in a rental property because your brother-in-law told you it was a good idea and you have no idea about operating expenses and cap rates, take the easy way out: Contact a commercial real estate appraiser and get your investment property appraised.

TIP

If you hire an appraiser for a commercial investment property, make sure that the appraiser is experienced in valuing the type of property you have. (Don't hire a residential home appraiser to tell you what your 20 percent of a commercial farming operation is worth.)

Your real estate partnerships

You may have an investment in real property that isn't a direct investment but is an investment in a limited liability company (LLC) or limited liability partnership (LLP). LLCs and LLPs are methods of ownership that have gained favor primarily because of their tax advantages.

TECHNICAL STUFF

The value of some LLCs and LLPs can vary greatly from year to year. Additionally, you usually have restrictions on how you can sell or otherwise transfer control of your ownership portion of an LLC or LLP. Those restrictions often result in a *valuation discount*, meaning that your portion of an LLC or LLP is actually worth less than you would calculate using your share of the income minus your share of the expenses. Consequently, you need to keep current — usually through regular statements you receive from the LLC or LLP — and adjust the value of your estate accordingly. Additional valuation discounts can also occur if you have a minority ownership or a lack of marketability discount from the underlying real estate asset.

For example, if you have an investment in a shopping center through an LLP, the shopping center's value can be dramatically affected if an anchor (main) tenant files for bankruptcy and shuts down the location at your shopping center. The property's revenue decreases, which in turn decreases the net operating income, ultimately decreasing the shopping center's value when you divide the net operating income by the cap rate.

You typically use LLCs and LLPs to own shares of more valuable investment real properties (such as large office complexes or an apartment complex with hundreds of apartments) rather than shares of properties you invest in directly (such as smaller office buildings or a duplex residential site). Therefore, the value of LLCs and LLPs is likely to fluctuate more than any direct real estate investments you have. Monitor them closely, not only for estate-planning purposes but also for personal investment purposes.

Calculating the Value of Everything Else: Your Personal Property

Get out a notepad or open a spreadsheet program, and get ready for some long lists of your *tangible* and *intangible* personal property. You need to be as thorough as possible so you can accurately figure out what your estate is worth.

Tangible personal property: Items you can touch

You'll likely see an interesting paradox with regard to your *tangible personal property* (cars, jewelry, the family silver and china, collectibles, and other household items). You probably have far more individual items of tangible personal property that you need to catalog and value than the other types of property in your estate (real property and intangible personal property). However, for most people, tangible personal property has the smallest overall value.

Some of your personal property may be almost worthless (or even totally worthless!) in a financial sense, but you still need to catalog those items and decide what you want to happen to them after you die. For example, who do you want to get the lucky Liberty nickel that your grandfather carried over on the boat when he came to the United States in 1898, the one that was handed down to your father and then to you? Maybe the nickel isn't worth much more than a nickel even though it's more than a hundred years old, but it still carries great sentimental value for your family. So, which of your four children will you leave that nickel to, and what other sentimental goodies will you leave to the others?

You could, of course, let your children, grandchildren, and other family members put in a claim on some or all of your trinkets while you're still alive — sort of a grab-bag approach to giving away part of your estate. But even if you decide to take that approach, you need to have everyone's "wish lists" and make sure your will reflects all those who-gets-what decisions.

But even setting aside small-value personal property, the rest of your tangible personal property can add up. Just take a look around your living room at the furniture and antiques, or in your den at that autographed 1969 New York Mets baseball and your collection of first-edition Hemingway novels.

TIP

The value of your collectibles could have doubled during the pandemic so it's certainly worth a closer look as you value your estate.

TIP

So, get cracking. You need to figure out what your property is worth, after you first figure out what you have. Overwhelmed at the thought? Here are a few tips to help:

- **Combine your estate-planning-related valuation of your tangible personal property with the same activities for insurance purposes.** Most homeowner's or renter's insurance policies require you to provide a list of your jewelry, collectibles, and antiques to be included beyond your basic coverage (often more than a certain dollar amount, or for certain types of items). If you need to spend the time cataloging those items and determining what they're worth for your insurance company, use those efforts for your estate planning as well!
- **Use videos to record your tangible personal property.** Cataloging hundreds of items can be very tedious, and even if you aren't prone to procrastinating, you may find some way to stretch out the process as long as possible. But if you have a video camera (and anyone with a smartphone has a video camera these days), you can take a guided tour through your home (as well as your second home, if you have one) and narrate the tour into the camera's microphone: "Here's that first-edition *Batman* that my idiot husband insisted be framed and hung over the sofa in the living room instead of the painting that I wanted to put there; it's worth. . . ."

- **Appraisal fees can really add up, especially for hundreds of items.** You can get a pretty good idea of what your tangible personal property is worth by using eBay or another online auction service for research. Look for the identical item (or one close enough and in more or less the same condition) that you have and check the final winning bid of recently completed auctions or current bids of active auctions about to close.

When you go through your home cataloging all your belongings, don't forget to poke around through often overlooked areas, such as the attic, basement, garage, or storage room. Also, if you rent an offsite storage unit, don't forget to inventory what you have there.

REMEMBER

Don't forget to also check your walls and even the ceilings in each room in your home! People routinely overlook artwork, chandeliers, other antiques, and even ceiling fan fixtures. You never know — that smear of paint on canvas hanging in your living room that you don't particularly care for but your spouse absolutely loves could be a now-valuable piece of contemporary art by a famous artist, worth enough to have a material impact on your assets and your estate planning!

Intangible personal property: Bank accounts, stocks, and bonds

Your *intangible personal property* — such as your bank accounts, stocks, mutual funds, annuities, crypto assets (cryptocurrency holdings and non-fungible tokens, or NFTs), and so on — may make up a substantial portion of your estate, particularly if you've invested your money wisely (and diversified your assets).

Fortunately, figuring out what most types of your intangible personal property are worth is fairly straightforward. (More about what's not so straightforward in a moment.) You can

- Check your bank statements for the value of your checking accounts, savings accounts, certificates of deposit (CDs), individual retirement accounts (IRAs), and so on.
- Find the value of any U.S. savings bonds you have stashed away from `www.treasurydirect.gov/BC/SBCPrice`.
- Look up the current prices of your stocks in your portfolio through any of your online trading accounts or contact your financial planner for the current fair market values of your accounts. You can do some simple, straightforward math to value your account — multiply the current stock price by the number of shares you own — if that isn't already calculated for you.

- Your brokerage account, or any widely used financial website such as CNBC (`www.cnbc.com`) or Yahoo! Finance (`https://finance.yahoo.com`) or a finance app on your phone will tell you the *net asset value* (NAV; a mutual-fund term meaning the actual value of each share) of the mutual funds you own, and you then multiply the NAV by the number of shares you own.
- Ask your broker for the value of your government or corporate bonds, or more complicated investments like call-and-put options and commodities futures.

TIP

As mentioned earlier, If you use an online trading account to track your portfolio's value, you probably already have the information described at your fingertips; just consult the trading firm you use to figure out the value of those investments.

You may have some intangible personal property that is a bit more complicated when it comes to figuring out its value. For example, you may have *stock options* from your employer. (Stock options give you the right to purchase shares of your company's stock at some point in the future at a guaranteed price per share, no matter how much higher — you hope, anyway — your company's stock price goes.) If you're one of the "head honchos" at work and you have a sizable stock-option package, consult with an experienced investment professional to help determine what your stock options are worth.

TECHNICAL STUFF

Valuing your stock options may be complicated, particularly if your company hasn't yet gone public. If your company hasn't gone public, you can't look up your company's stock price in the newspaper or online because your company isn't yet publicly traded. And even if your company *has* gone public, the real value of your stock options isn't quite as simple as if you actually owned those shares of your company's stock covered by those options, where you simply multiply the number of shares by the price per share. To calculate the precise value of stock options, investment professionals use complicated factors and terms, such as *intrinsic value* and the Black–Scholes model. Sound confusing? If you want to find out more about valuing stock options, check out *Stock Options For Dummies* by Alan R. Simon (Wiley).

Dead Reckoning: Subtracting Your Debts from Your Assets

In Chapter 1, we mention that in addition to your *positive balance* assets — real property, tangible personal property, and intangible personal property — your estate's value must also include *negative balance* (amounts you owe).

After you figure out the value of your assets, you simply add up all your debts and subtract that total from your assets to give you the net worth of your estate. These debts include the outstanding balances on

- Any real estate–related loans, including the first mortgage on your home, any second mortgage you may have, the unpaid balance on a home equity loan, the mortgage(s) on a second home, and so on, including judgments
- Your student loans
- Your credit cards
- Any automobile loans or loans on other vehicles, boats, airplanes, and so on
- Any personal loans, whether from a bank or a person
- Department store loans or other retailer charge accounts
- Any margin loans with your stockbroker
- Future debts you're sure you'll incur, such as paying for your children's college education

TECHNICAL STUFF

If you have any kind of credit-related life insurance — mortgage insurance, credit card insurance, and so forth — that will pay off the balance of a particular debt, then that life insurance effectively cancels out the debt for purposes of calculating your estate. So, don't forget to consider any credit-related life insurance when you're adding up all your property and debts. However, credit-related life insurance isn't a particularly good idea if you can get life insurance elsewhere. For more information, see *Insurance For Dummies*, 2nd Edition, by Jack Hungelmann (Wiley).

Giving Gifts throughout Your Life to Reduce Your Estate's Value

You may have seen the expression that was popular on bumper stickers and posters way back in the mid-'90s: "He who dies with the most toys wins."

Well, not when it comes to estate planning and, specifically, death taxes! As we discuss in Part 4, the more your estate is worth when you die, the bigger the tax bite. So, part of your estate-planning strategy may be to give away some of those toys while you're still alive, effectively transferring those assets from your estate to someone else's estate.

WARNING

You need to remain aware of many complications with gift giving, such as annual limits on the value of gifts, lifetime asset transfer limits, strategies where you and your spouse coordinate your respective gift giving, and tax implications. In Chapter 11, we discuss how gifts and gift taxes apply to your estate planning. You also need to pay attention to a big difference in how the exact same property is treated tax-wise for a gift versus being passed to someone after you die (see the sidebar "Step right up").

For now, though, realize that as you tally up all the property in your estate and the property's value, you need to work with your estate-planning team to figure out whether gift giving makes sense for you and, if so, how to get started on a sensible, tax-managed gift plan.

TIP

You also need to consider gift giving even if financial and tax reasons don't come into play. For example, you may want to give certain items of sentimental value to a family member or friend, or perhaps a charity or foundation, instead of waiting until your estate is settled (and you're no longer alive). Even for these sentimental items, consult with your accountant to determine any tax implications.

STEP RIGHT UP

Giving someone a gift versus leaving that very same property to that very same person as part of your estate can have vastly different tax consequences — for them.

Suppose you bought 1,000 shares of stock in a start-up company for $10,000 more than 30 years ago, and in the decades that have passed, the company has not only survived but thrived — big-time. Your original $10,000 of stock is now worth $100,000!

If you give those shares to your daughter and she turns around and immediately sells that stock, for tax purposes she will have a long-term capital gain of $90,000 (her $100,000 proceeds minus the $10,000 cost). Why? Because when you give a gift, the recipient acquires your original cost basis, which is known as the *carryover basis.*

Now suppose that instead of giving that stock to your daughter as a gift while you're alive, you leave all those shares to her as part of your estate, and she inherits your $100,000 of stock after you die. In this case, unlike with the gift, she doesn't acquire *your* original cost basis. Instead, the cost basis is *stepped-up* to the value at the time of inheritance. So, if she sells all that stock the same day she receives it, she will save a bundle on capital gains taxes because her gain is now effectively zero ($100,000 proceeds minus a stepped-up cost basis of $100,000).

Keep in mind, though, that the stepped-up basis for inherited assets exists under current estate tax law, which could conceivably change in the future. In fact, most major pushes over the years to "reform" estate tax law have targeted (among other things) the stepped-up basis for inherited assets. So, you never know what could happen in the future. But at least for now, you should probably give some thought to the tax implications of gifts versus inheritance, even though those tax implications are for the people you give or leave things to, rather than for *your* estate.

Calculating Adjustments in Your Estate's Value Due to Major Changes in Asset Valuations

Like pretty much everything else related to estate planning, you need to be very vigilant about keeping up-to-date with the change in your estate's value over time.

Changes in your life can dramatically alter your estate's value and, in turn, cause you to rethink your overall estate planning and how you want your estate divided after you die.

For example, if you get divorced (particularly if you live in a community property state; see Chapter 5), your estate's value will likely change dramatically as a result of the divorce settlement. Or, on a more uplifting note, if you win the lottery or have the value of your stock portfolio go way up, your estate's value also increases and you may want to rethink your estate plan.

WARNING

If you ignore dramatic changes in your estate's value, you run the risk of having an out-of-date estate plan that doesn't come close to reflecting what your original intentions had been.

For example, suppose you have two children, and in your estate you have $200,000 in various CDs and Treasury bills, plus $200,000 worth of some hot new cryptocurrency that you purchased at the most recent peak in cryptocurrency prices. When you finally got around to preparing your will later that year, you decided to leave the $200,000 in CDs and T-bills to your daughter and your cryptocurrency to your son.

Now, however, that hot new cryptocurrency has joined the graveyard of a lot of other fad investments and is nearly worthless after a big-time crash. Sure, cryptocurrency prices could go on another run and the value of your crypto investment could rise from the ashes and get back to $200,000 or maybe even more.

WARNING

Right now, though, your estate is seriously "unbalanced" when it comes to what you plan to leave your two kids. If you die before you update your will, your daughter will get the current value of the CDs and T-bills (now a little bit more than $200,000 because of interest earned since you prepared your will and did your initial estate planning), but your son will get a whole bunch of worthless crypto. Because your intention had been to divide your estate *equally* between your two children, you first need to acknowledge that your estate's value has changed, and then you need to update your will to reflect those changes and a new strategy of who gets what.

As we discuss in Chapter 3, if your intention had been to leave each of your children equal shares of your estate, you could have — and should have — divided those assets equally between your daughter and your son. If you had done so, you wouldn't have to update your will simply because of the dramatic change in your estate's value.

2

Where There's a Will, There's a Way

IN THIS PART . . .

Take a scenic journey through the land of wills.

Know the limitations as to what you can specify in your will.

Navigate the sometimes treacherous waters of probate.

Use a will substitute to get around probate.

IN THIS CHAPTER

» Getting your ducks in a row for your will

» Looking at different types of wills

» Selecting from the what-goes-into-your-will menu

» Keeping your will safe

» Making changes to your will down the road

» Making sure that what you specify in your will remains in effect after you're gone

» Understanding what your current will status is and what the implications are

Chapter 3 Understanding the Basics of Wills

Your will is the number-one legal weapon you have at your disposal to make sure that your estate is divided and distributed according to your wishes after you die. Basically, think of your will as your voice from beyond the grave to make it absolutely clear who will receive your assets, and to prevent unintended and unpleasant side effects to your well-thought-out estate plan.

But sometimes the best-laid plans of mice and men (well, make that women and men — we've never seen a mouse that has a will) are thwarted by selecting a type of will that is inappropriate or inadequate for the particulars of a given estate or by leaving out key wording that is necessary to make a will valid. And sometimes your will can be 100 percent perfect for you and your estate at one point in your life, but you neglect to keep your will up to date with changes in your life. By not keeping your will updated, your estate and the people you want to take care of after you die can have serious troubles.

You must also take care to keep your will very "matter of fact." You may have seen movies or TV shows where someone uses a will as a from-the-grave statement of love, hate, indifference, generosity, stinginess, or some other emotion. If you use your will in that fashion (something like "To my eldest son, who has always disappointed me his entire life, who never sent me any cards, who married someone I despise, I leave absolutely nothing"), you open the door to all kinds of problems. You can make a mistake in your wording choice that can cause your will to be invalid. Even if your will is letter-perfect, you can open emotional wounds and cause psychological scars that could take years (and lots of expensive therapy!) to overcome. So, in your will, you should stick to — like the detectives on *Dragnet* used to say — "just the facts!"

In this chapter, we focus on the basics of wills necessary to ensure that your will is the most appropriate for your wishes and needs and that your wishes will be carried out.

GETTING TECHNICAL WITH TERMINOLOGY

One of the primary purposes of creating a will is to financially take care of your *beneficiaries.* However, if you fail to properly prepare your will, your *heirs* may wind up with less than expected, or maybe with nothing at all. Legal double-talk? Not exactly. People (such as your family members and friends) and institutions (such as charities) that you take care of in your will are called *beneficiaries.* However, if you don't have a will — or don't have a valid will, as we discuss later in this chapter — the individuals who benefit from your estate are determined by state law and are usually called *heirs* (or *heirs at law*).

In layman's language, the terms *beneficiary* and *heir* are often used interchangeably. However, the two words technically have a significant distinction.

Planning for Your Will

TIP

We advise that you work with your attorney to create and take care of the technical and legal details of your will. Even the simplest, most straightforward wills are filled with legal terminology. Your attorney has likely prepared hundreds or even thousands of wills. Why not leave the details to someone for whom the legal-speak and technicalities are second nature?

WARNING

You'll find a significant proliferation of prepackaged wills available online. The main selling point to this quick-and-easy, fill-in-the-blanks approach to wills (and trusts) is their relatively low cost — that's why you'll see catchy taglines such as "$99 for All Your Estate Planning Documents." These ready-to-go documents may serve a purpose in some *very* basic estate planning, but as soon as you run across specifics from *your* estate planning that aren't easily met by the off-the-shelf approach, you probably need to shift your focus to having an attorney handle your will. (See the "How about a preprinted, ready-to-fill-in will?" sidebar later in this chapter.)

But before your attorney starts putting anything on paper for your will, you need to consult with them to determine what your major objectives are. Be sure to specifically discuss the following items:

- **What your tax exposure situation is based on your estate's value:** Your estate may have to pay federal estate tax and any state estate or inheritance tax if your estate is worth more than the allowance at which taxes are owed. (We discuss how to figure out what your estate is worth in Chapter 2, the federal estate tax in Chapter 13, and state estate and inheritance taxes in Chapter 10.) Your will needs to reflect your overall estate planning, including your tax planning, so both you and your attorney need to clearly understand all tax implications to your estate.
- **Who you want to explicitly take care of:** You can write your will in many different ways to outline to whom you want to give what portions of your estate. However, you need to have a general idea of which family members you want to take care of, such as:
  - Your spouse and children
  - All your children (including adopted children and step-children)
  - Only some of your children
  - All your children and all your grandchildren
  - All your children and your brothers and sisters
  - Your parents and your brothers and sisters

- Only two of your four children and all except one of your sisters
- Your pets (you can reference "any pets that I have at the time of my death" as a catchall to cover all your future pets)

» **Whether you want some part of your estate (or even all of your estate) to go to one or more charities, foundations, or other institutions:** Later in this chapter, we discuss different ways in which you can divide up your estate among those you want to include in your will.

TIP

The first time you sit down with your attorney, make sure to talk about the value of your estate, the individuals (family members and others) and institutions you want to leave your estate to, and *continuity of care* concerns such as long-term care at home or facility care such as independent living, assisted living, and nursing home concerns. Your attorney will then clearly understand your motivation and can help you prepare a will that accurately reflects your situation and preferences.

Getting to Know the Different Types of Wills

Before you even think about what wording you should put in your will, you first need to decide which of several types of wills is right for you. The good news is that you can usually stop your search for the perfect type of will with the first type we discuss: the simple will. However, you should be familiar with the other types in case your attorney advises that some unique aspect of your estate makes one of these other types more appropriate.

Simple wills

Almost always, a *simple will* is the will of choice for you. A simple will is a single legal document that applies only to you (unlike a *joint will* for you and your spouse, which we discuss briefly in the next section).

A simple will describes

» Who you are, with enough information to clearly identify that document as your will.

» The names of your beneficiaries, both people (whether those people are family members or not) and institutions (such as charities), and enough information about the beneficiaries (such as their birth dates to distinguish among multiple family members with the same name, for example) so whoever is reading your will can figure out to whom you're referring.

- The name of the person who you're appointing to be the *executor* of your will. The executor is the person who is legally responsible for making sure that your directions are carried out. You also need to appoint a backup executor — or maybe even a backup to the backup — if, for any reason, your designated executor is unable to perform the official duties (sounds like the Miss America Pageant!).

  TIP

  Always check with whoever you specify as an executor or backup executor in your will before putting that person's name in your will. You want to avoid unnecessary complications that may arise if that person is unwilling or unable to serve as your will's executor. (We discuss the factors you need to consider when choosing an executor — also called a *personal representative* — along with the responsibilities that go along with that role in Chapter 5.)

- Your directions as to who will care for your children, pets, or anyone else you're legally responsible for.
- How you want your assets distributed, and to whom, after you're gone.

Your simple will should be *typewritten* (a term that comes from the days of old-fashioned typewriters but that also applies to a printed and produced document by a computer and printer). Other forms of your will, such as those written in your own handwriting or spoken (we discuss both forms briefly in the next section), usually have problems and should be avoided.

Other types of wills

You have other options for your will besides the simple, typewritten will we discuss in the preceding section. Other choices, along with the drawbacks of each, include the following:

- **Joint will:** A single legal document that applies to two people (you and your spouse, for example). Some married couples mistakenly think that they're required to have a joint will or that a joint will is better for them than two simple wills. Indeed, a single joint will may be less expensive to have prepared than two simple wills. However, joint wills are usually a bad idea. The primary problem is that most courts treat a joint will as a form of a *contractual will,* which is a will or contract that is irrevocable and can't be changed after one party dies. Therefore, if your spouse dies first and you want to revise the contents of your joint will for estate planning or tax purposes, you probably can't. Joint wills can be problematic, because the death of a spouse can cause a change in your circumstances and how you want to leave your estate to your loved ones. Don't even think about a joint will unless your attorney suggests that some particularly unique aspect of your situation makes a joint will advisable, and then ask your attorney to explain, explain, and explain some more!

- **Mutual will:** A legal document you can use to coordinate your estate planning with someone else, such as your brother. For example, suppose you and your brother want to leave a substantial amount of money to be split among two charities — Charity A and Charity B — that both of you have supported for many years. You can create mutual wills in which:

  - No matter which one of you dies first, 75 percent of either your estate or that of your sibling goes to Charity A, with 20 percent going to Charity B and 5 percent going to some other beneficiary.
  - When the other one of you dies, 50 percent of that person's estate goes to Charity B, with 30 percent going to Charity A and 20 percent designated for some other beneficiary.

  Basically, because you don't have a crystal ball to tell you and your sibling which one of you will die first (and even if you did, would you really want to know?), you both set things up so no matter what happens, Charity A receives a larger amount of money first than Charity B does.

  If you think a mutual will is particularly suitable for some unique aspect of your estate, ask your attorney and then proceed with caution.

- **Holographic will:** The technical term for a handwritten will. A holographic will is handwritten and signed by you. A handwritten will doesn't require an attorney to be involved when you prepare this form of will. However, only some states recognize a holographic will as valid, which means that you may think you have a valid will, but in fact you don't.
- **Nuncupative will:** A technical term used to describe a spoken will and has nothing to do with Sister Maria or any of the other nuns from *The Sound of Music.* (Everybody sing along: "How do you solve a problem like Maria's estate planning?") Even though creating a nuncupative will is extremely easy — all you have to do is talk and have someone present to listen — you have many complications and limitations. Some states only allow people who are on their death beds (literally!) — about to die any minute — to use nuncupative wills for last-minute expressions of what they want done with part of their estates. Some states allow only certain types of property or property only up to a certain dollar amount to be transferred with a nuncupative will.

WARNING

Don't use any of the preceding nonstandard types and forms of wills — or any others that may arise in the future.

Choosing Your Will's Contents

Your will is composed of a number of *clauses* that when put together into a single legal document, accurately and precisely represent your wishes for your estate. The clauses in your will fall into three categories:

- **Opening clauses:** These clauses provide basic information about you and also lay the groundwork for the other clauses in your will that follow.
- **Giving clauses:** These clauses follow the opening clauses and comprise the main body of your will, in which your who-gets-what-part-of-my-estate strategy is specified.
- **Ending clauses:** These clauses help to make your will valid by making sure that all statutory requirements have been met.

WARNING

However, just like you put together a bicycle, bake blueberry muffins, or do anything else in which you need to combine parts or ingredients together, you need to make sure of three things:

- That you select the right parts or ingredients — or in the case of your will — the right clauses
- That you put those parts, ingredients, or clauses together in the right order, with the right number of each to make sure that the finished product is what you intend it to be
- That you've spent time *seriously* thinking about what you want because these thoughts are the foundation to create your will

If you leave out or mess up just a single essential clause, you can completely change your intentions or even make your will invalid. And because clauses can get very technical with all kinds of legal terminology, have a professional, such as your attorney, prepare your will for you. (See the sidebar "How about a preprinted, ready-to-fill-in will?")

HOW ABOUT A PREPRINTED, READY-TO-FILL-IN WILL?

Many do-it-yourself preprinted will forms are available, and some people use them to save money (as compared to meeting with an attorney and having a will created from scratch). The proliferation of online wills and TV ads for wills costing less than a grocery shopping trip may seem enticing as a shortcut. Chances are, though, your individual needs require you to customize your will to some extent, meaning that in most cases, preprinted will forms won't be quite right for you, even though many of these will forms are advertised as suitable for complicated situations.

Therefore, you most likely have to do at least some customization if you use a preprinted will form. As soon as you begin customizing, you open up the possibility of all kinds of problems. Why? First, you need to be sure that you're satisfying legal requirements specific to your own state; otherwise, your will may not be valid. If you're going to put the time and effort into preparing your will, you certainly want the finished result to be legally binding.

Second, you're better off starting to work on your will with a clean slate rather than preprinted boilerplate language; doing so actually forces you to decide what to include in your will.

However, if you think that your specific situation is so uncomplicated that a preprinted will form may do the trick — and you really are trying to spend as little money as possible on your will and your estate planning — then we recommend that you at least get an attorney to look over your filled-in will form after you're completed it and to advise you if the finished document may have any problems. If you have limited financial resources, you can usually obtain low-cost or even no-cost basic legal assistance within your community; just check around.

Opening clauses

Think of the opening clauses of your will as a preamble in which you provide some basic information to set up the giving clauses that follow. Your will's opening clauses include the following:

- An introductory clause that
  - Clearly identifies you as the maker of the will.
  - Explicitly states that you created this document of your own free will (this part is where you write "being of sound mind," like in the movies).
  - Explicitly states that any wills you previously created are no longer valid.

- A family statement clause, in which your family members referenced later in your will are introduced.
- A tax clause (see Chapter 10) — the structure of your will needs to align with your overall tax strategy for your estate. You can include a tax clause to specifically state how you want taxes to be paid — often out of the *residuary* (everything else) part of your estate, as we discuss later in this chapter. But if you want to specify some other tax strategy in your will, you use the tax clause to state how you want taxes to be paid, by whom, and from what part of your estate.

TIP

Your attorney likely has a favorite way of preparing opening clauses, based on hundreds or thousands of wills they've prepared. Still, before your attorney starts writing anything for your will, make sure to discuss your overall strategy. Don't be afraid to speak up, ask questions, and decide what *you* want — this is *your* will, not your attorney's will.

Giving clauses

The heart of your will may contain the giving clauses in which you specify as precisely as possible how your estate is to be divided among your beneficiaries. In general, you can take one of three different approaches to how you want your estate divided and how the contents of your will's giving clauses will be written:

- You can be extremely general.
- You can be extremely explicit and detailed.
- You can be very explicit about part of your estate and very general about the rest of your estate.

The simplest approach you can take for your will is to basically lump all or almost all your property together, identify the beneficiaries who will share that property, and simply leave all that property to the entire group of beneficiaries to be divided up equally. For example, if you have an estate worth $500,000 that is comprised primarily of bank accounts and stock; your spouse has died before you; you live in a rented apartment and no longer own a home; and you want to divide your estate up equally among your four children, all of whom are still alive, then you can take the be-extremely-general approach and just leave that $500,000 worth of property to all your children, each of whom will get an equal share of your estate.

But suppose you have an estate worth $3 million, a significant portion of which is made up of collectible cars and several vacation homes? And suppose you not only have two living children from your third (and current) wife, but also seven living children from previous marriages, not to mention several stepchildren? And what if you not only want all these children and stepchildren to share in your estate, but also your two sisters, but not your two brothers?

In this example, you must be as explicit as possible in your will about who will receive specific property from your estate. Which child will receive the 1955 Thunderbird? Who will get the 1967 Corvette, and who will get the 1965 Pontiac GTO? Should your sister who works at Apple get your Apple stock and your other sister who works at Tesla get your Tesla stock, or should you give your Apple stock to your sister who works at Tesla and your Tesla stock to your Apple-employed sister to help each sister diversify their respective portfolios? Should Peter Piper pick a peck of pickled peppers and a woodchuck chuck wood, or in the interest of diversification should Peter Piper chuck wood and that woodchuck do the pickled pepper picking? (Just kidding about that last part.)

The third strategy for your giving clauses — somewhere in between very explicit and very general — can be useful if you want to divide most of your estate equally among your children, but you still want to explicitly leave other smaller amounts of your estate to your grandchildren, parents, brothers and sisters, a favorite niece or nephew, or a charity.

So, regardless of which of the three strategies you want to follow, how do you use your will's giving clauses to make it all happen? You can use:

- Real property clauses
- Personal property clauses for intangible and tangible property
- Residuary clause
- Appointment and fiduciary powers clauses

Real property clauses

Your real property — for most people, their home (see Chapter 2 for other types of real property) — is often the most significant asset in terms of dollar value that you leave to your loved ones — quite possibly far more valuable than all your personal property put together.

If you want to explicitly leave real property to one or more beneficiaries, you use a *real property clause,* which is a straightforward statement that reveals who is to receive your real property, identifies the property to which you're referring, and names who is to get that property.

WARNING

Often, homes are left to loved ones with the intent to retain the family legacy and continue building generational memories: "This was your grandparents' house, and it will be yours someday, too." The reality is that the real property you leave may not be something that your loved ones have interest in keeping, not to mention take on all the expenses associated with the property — real estate taxes, property insurance, and general upkeep. The real estate taxes alone, especially in coastal cities, can cost tens of thousands of dollars annually, even if that ancestral family home is fully paid off. Just keep in mind that your beneficiaries may not be able to retain the property you want to keep in the family and may sell the property. If you discuss this with your loved ones ahead of time, you can save everybody a lot of heartache (not to mention the guilt over selling your parents' home, which may have been your childhood home) and time by explicitly having your executor sell your house upon your death and distributing the proceeds to your beneficiaries as you predetermine.

Personal property clauses

If you're following the be-very-explicit strategy for your will, then your will must contain personal property clauses specifying what will happen to both your intangible and tangible personal property. In the case of your intangible personal property, such as your stocks and bonds, you can specify who your Apple stock goes to, who your Tesla stock goes to, and who gets your collection of nonfungible tokens (NFTs) that are now worth a fraction of what you originally paid (just kidding about that last one).

Even though you plan to utilize the partly-general-and-partly-explicit will strategy, you can still use a personal property clause to identify some stock or other intangible personal property that you want to go to someone different. For example, if you're leaving the majority of your $750,000 estate to be divided among your children, but you want to leave each of your five grandchildren $10,000, you can use this strategy.

For your tangible personal property, you can divide up your personal items among your beneficiaries. Very often, you want to specify what will happen to sentimental, small-in monetary-value-but-large-in-heart-value (whew!) items, such as your grandmother's antique quilt or your great-great-great-great-grandfather's diary that he carried through the Civil War.

The residuary clause

Technically, your will's *residuary clause* covers the leftovers in your estate that you didn't explicitly mention in real property clauses or personal property clauses. The residuary clause gives you and your will a safety net in case you forget to specifically identify some part of your estate in your will. Think of it as an asset catchall clause.

REMEMBER

DON'T FORGET YOUR DIGITAL ASSETS

You need to keep in mind any digital assets, why they're different from your other assets, and how to account for them in your will. It isn't sufficient to just list any digital assets you own — Bitcoin, other cryptocurrencies, NFTs, or any other blockchain assets in your will. You need a detailed game plan, because your beneficiaries will need to know not only that you *have* these digital assets, but also how to find and access them. The unique nature of these assets is that they're stored in digital wallets with passwords, private keys, personal identification numbers, codes, or other security protection.

Create a *digital assets memorandum* (DAM) as an accompanying document to your will. You should state in your will that your digital assets information is contained in the DAM that is stored with your other estate planning documentation. As a separate document from your will, you control who sees the DAM's confidential information. The DAM should include specific details and step-by-step instructions on the digital assets, where they're located, how to find them, and any and all passwords or other security measures required to obtain them. Pretend your executor knows nothing about digital assets (which they may not) and explain everything in simple, basic terms. If your instructions are like trying to find the elusive "Where's Waldo" (as in, really difficult to find), redo them in simpler terms.

REMEMBER

Your estate can change over time, and if you haven't updated your will lately, you may have some particular item (often tangible personal property, such as a valuable painting you may have recently acquired) unaccounted for. This is more common than you would think, so the residuary clause is an important clause to include in your will.

However, you can use your will's residuary clause for far more than just the leftovers (actually, your entire estate or the majority of your estate) if your will strategy is to be as general as possible. You simply don't use any other giving clauses to explicitly mention real or personal property (as we describe earlier), which forces your estate into being covered by the residuary clause.

Or if you want to take that in-between approach to your will, you can use specific giving clauses for whatever real property and personal property you explicitly want to give to someone and use a residuary clause to cover everything else.

WARNING

No matter what your will strategy is, don't forget to include a residuary clause! Even though you may want your will to be as explicit as possible, you'll almost always have property in your estate that falls into the leftovers category. Make sure to designate one or more beneficiaries to receive those leftovers.

Appointment and fiduciary powers clauses

The section of your will that includes your giving clauses also contains some additional clauses that actually don't have anything to do with how your estate will be divided. You use the *appointment clause* to name the person you've chosen to manage your estate. At the time you prepare your will, you need to decide who you feel is the best person to handle your estate and act as your *personal representative* after you die. (We discuss your personal representative and the role in managing your estate further in Chapter 5.)

The *fiduciary powers clause* is a companion clause to the appointment clause that gives you the ability to provide your personal representative with powers beyond what may be available in your state statutes.

For example, use the fiduciary powers clause to specify that your personal representative will provide your children with some amount of income on an interim basis until your estate is settled. Another way you can use the fiduciary powers clause is to allow your personal representative to continue operating your solely owned business that still provides income to your estate.

Ending clauses

After you complete the most difficult part of your will — the giving clauses portion, which should reflect your overall will strategy — you need to finish up your work with your ending clauses that include the *signature clause.* The signature clause is where you date and sign your will.

Your will's witnesses also sign the will along with appropriate language that indicates that they witnessed you signing your will and that you executed the will voluntarily and did so of your own free will. (In other words, you weren't coerced or perhaps unconscious with a devious family member putting a pen in your hand to make you "sign" your will. Hey, this would make a good storyline for a movie.)

REMEMBER

Make sure that your will's witnesses are *disinterested parties* who are not beneficiaries in your will.

TECHNICAL STUFF

Most states recognize that a will can be *self-proved*, which is a method of avoiding the requirement of producing witnesses at the time of probate to prove the validity of the signature of the *decedent* (the person who died). In the usual case (with a "non-self-proved will"), the person making the will simply signs the will in the presence of witnesses, who also then sign their names as witnesses. In a self-proved will, however, the signature of the person making the will is acknowledged in addition to being witnessed, and the witnesses also execute affidavits. The necessity of providing witnesses at the time of probate is, therefore, avoided.

FOR FANS OF JOHN GRISHAM OR *THE LINCOLN LAWYER*

TECHNICAL STUFF

We've taken great care to use plain English in discussing your will and the clauses that make up its contents. But if you're one of those people who can't wait for the next John Grisham novel or the next season of *The Lincoln Lawyer,* and if you counter your kid's dinnertime complaints with either "I object!" or "You're out of order!," then the legal-speak of wills may be of interest to you. Here are some of the legal terms you may come across:

- **Exordium clause:** The introductory clause in your will where you state "I, John Doe, of the City of Tucson, County of Pima, and State of Arizona, being of sound mind and under no undue influence . . ." and all the rest of the beginning of your will.
- **Dispositive clauses:** The technical term for your will's giving clauses in which you specify who is to receive various parts of your estate.
- **Devise and devisee, bequeath, bequest, and legatee:** Technically, you *devise* (give) your real property to your *devisee* and your personal property is a *bequest* (also called a *legacy*) given to your *legatee.* And for bequests, you use the word *bequeath* instead of *devise* to mean "give." However, these types of property and the associated language have blurred over the years. According to `https://dictionary.law.com`, "The distinction between gifts of real property and personal property is actually blurred, so terms like *beneficiary* or *legatee* cover those receiving any gift by a will." Likewise, the same site describes *devise* as "an old-fashioned word for giving real property by a will, as distinguished from words for giving personal property."
- **Testamonium clauses:** The technical term for your will's signature clauses.

Safeguarding Your Will

Here's a quick quiz, and the answer may surprise you: On what single point about wills are estate-planning professionals more likely to passionately disagree?

The answer: whether or not you should keep your will in a safe deposit box.

Some experts contend that you must keep your original, signed will in your safe-deposit box and that you must also make several copies of your will (or have your attorney make several copies) and give a copy to your personal representative. You must also give copies to certain family members or friends (different people than your personal representative) like your children or your brother or sister, for example. Because other people may have copies of your will, it's important to have a separate DAM (see "Don't forget your digital assets," earlier in this chapter) so you control who sees the DAM's confidential information.

Other experts argue that your will shouldn't be kept in a safe-deposit box, but rather in a safe at your attorney's office or a fireproof safe at home. The reason for not using the safe-deposit box for your will, they contend, is that after you die, your safe-deposit box may be sealed until probate (depending on what state you live in) or at least be subject to highly restricted access. For example, your safe-deposit box may be accessible only by a person whom you designated on the signature card when you opened the box and only during a visit supervised by a bank official and possibly audited by your attorney or the taxing authorities. And in some states, the only items that can be removed from the safe-deposit box are your will and burial plot deed.

Our suggestion: Ask your attorney what they recommend and follow those guidelines. If you live in a state where safe-deposit boxes aren't sealed, your attorney may advise you to keep your signed will in your safe-deposit box. But if you live in a state that does seal safe-deposit boxes, you may be advised to keep your signed will with your attorney or at home.

TIP

You should only keep your will at home if you have a fireproof safe. That stack of to-be-filed receipts, to-be-replied-to-letters, and candy bar wrappers on your desk in your den or a corner of the family room is no place for your will!

Also, regardless of where you safeguard your original will, you must also keep an unsigned copy of your will for yourself so you don't need to touch the original signed copy in your safe-deposit box. If you want to double-check to whom you left a particular item or some other detail in your will, or scribble a possible change that you want to ask your attorney about, you won't risk invalidating your will by damaging or defacing it.

You should also give unsigned reference copies of your will to key family members and others, so your family can start planning for what will happen to your estate.

Of course, if you have a flair for the dramatic and don't want anyone to know what's in your will until after you're dead, you can always do the bad-movie-plot version and give no one a copy at all, but we strongly advise against that approach!

Changing, Amending, and Revoking Your Will

Now that you have completed your will, you may assume that you're done with it. Even though you've completed the tough process of formally expressing what you want to be done with your estate, you still must keep it up to date. Often, working on your will can be an emotional process for you as you decide who will get your best dishes when three different children and grandchildren have explicitly expressed their interest with comments like, "Boy, I sure do love those plates" at your family dinners. Nevertheless, you've finally made your tough decisions, you want to put the whole process behind you, and you're tempted to simply put your will in a safe place so that someday in the future your "wishes for your dishes" will be carried out.

WARNING

Don't make the mistake of putting your will away and forgetting about it. You must make sure that at all times, the details of your will reflect changes in your life that occurred after you initially executed your will.

TIP

All of your estate planning documentation — wills, trusts, power of attorney — should be reviewed at least annually. Add a recurring calendar reminder to review your will to make sure everything is still up to date and accurately reflects what you want done with your estate.

Why you may need to change your will when something happens

Your will is a dynamic, living document because your life and tax laws are dynamic and ever-changing. Ironically, although a will's intent is to provide for what happens to your estate after you've died, the reality is that your will needs to change as your life changes. Think about the climactic last scene of some old black-and-white movie, where the stoic attorney reads the deceased's will aloud as the family members gather around to see what rich oil magnate Grandfather has left them. In that last scene, almost everyone is surprised to find out that Grandpa had made changes to his will as family members drifted in and out of favor, and at the time of his passing those who were out of favor receive nothing except a token amount of cash and a stern from-beyond-the-grave lecture (while those family members who Grandpa favored the last time he updated his will are all ear-to-ear smiles).

This classic movie scene can serve to remind you that those shocked family members were probably blindsided because of some change made to the will that they weren't aware of at all. You need to keep this scenario in mind because your life does change — marriages, children, divorces, increases in your estate value, and so forth — and your will may need to change with these life changes.

The reasons you need to change your will vary. The following are typical times to change a will:

- **After a marriage:** You need to include your new spouse in your estate plan.
- **After a divorce:** You most likely want to absolutely, positively, and certainly make changes to the list of what you had previously been planning on leaving to your now ex-spouse.
- **After your spouse's death:** Most likely, you had left a significant portion — or perhaps all — of your estate to your spouse in your will, and now that your spouse has died, you need to update your will to adjust who you now want to leave your assets to.
- **After the death of one of your heirs or dependents:** Suppose your will has specified that a particular person is to receive a specific asset. If that person dies before you do, you need to update your will to reflect who you now want to receive that asset.
- **After you experience a significant change in your estate's value:** For example, your stock holdings may go way up (or way down!). You should now reevaluate who gets what and how much.
- **After any other change in your life that causes you to reevaluate who you want to leave something to:** For example, you become passionate about a specific cause and decide that you want to leave a large portion of your estate to some charity that champions that cause.

WARNING

If the change to your will is triggered by an emotional event, such as being extremely angry with a family member and wanting to write them out of your will, allow yourself some time to clear your head before you act. Make changes or amendments to your will after life changes and not after an emotional reaction that may dissipate over time.

Ways to change your will

You can change your will in one of two ways:

- You can create an entirely new will that supersedes your current will.
- You can change or delete specific parts of your current will, or add new parts, while leaving the rest of your current will unchanged. You do so through a new, separate document and not by directly altering your original will itself.

Each of these two methods has advantages and disadvantages. In most cases, simply creating an entirely new will with the changes, additions, and deletions is what you want to do. Creating an entirely new will is relatively straightforward, especially because your will was most likely prepared with good old standard word-processing software such as Microsoft Word or Google Docs (so your attorney doesn't need to have an entirely new will typed from scratch — with carbon paper for extra copies — like in the olden days before computers).

REMEMBER

However, you can also add, change, or delete specific parts of your current will *without* creating an entirely new will through a form called a *codicil.* A codicil is a separate document that adds to your original will.

WARNING

Codicils are often expressed in the context of specifically referenced portions of your will. Because a codicil needs to clearly reference a specific portion of your will that it's amending, ask your attorney to prepare any codicils instead of trying to do them yourself, no matter how simple it may seem to just write or type a couple of lines of text. If you mess up, your codicil most likely won't be valid.

When should you use a codicil?

- When your original will is very long and you want to make only a few, minor changes.
- When your competency at the time of executing the codicil may be challenged. If someone does successfully argue that you were losing your grip in later years, the codicil may be overturned without affecting the will itself.

Protecting Your Loved Ones from Your Unloved Ones

Perhaps your family bears an uncanny resemblance to an episode of *The Waltons* (still showing in reruns on cable!) or maybe a family scene from an old Norman Rockwell painting. Everyone gets along most of the time, and every holiday dinner creates new lifelong memories (sigh!).

Or, on the other hand, maybe your family is more like an episode of a soap opera. Lots of bickering and arguing, one family member not speaking to another for years . . . you know the story. Quite possibly, then, your family consists of loved ones and "unloved ones." Suppose then, that you decide that your unloved ones will receive little or nothing from your estate. If you've made that decision and you're willing to live with it (so to speak, because they may not find out your decision until after you've died), then you need to be concerned with more than just figuring out how to leave those individuals out of your will. You also need to be concerned with protecting other family members — your loved ones — so that they justly get what you want them to receive without interference from the others who you decide to leave nothing.

WARNING

You may think that the most logical way to not leave anything to unloved ones is to simply leave them out of your will (basically, not to mention them at all), but that may be the worst thing you can do! Why? Because doing so leaves the door wide open for the unloved ones to contest your will by saying they were excluded by accident. ("You know, he was always so distracted, he obviously forgot to mention us. After all, we're blood relatives. Why wouldn't we be in his will?")

Therefore, you need to explicitly state your intentions for your unloved one in your will, no matter how painful it may be to form those words and commit them to paper. Your attorney can help you with the language to include, as well as help you to keep those words as factual and unemotional as possible.

TIP

A simple way to handle the wording problem is to mention the unloved ones in your will, but to leave them only a small or token sum. That way, they can't claim that you overlooked or forgot them and you don't have to explain in your will why they're otherwise excluded.

Still, after you die, those unloved ones may try to overturn your wishes to receive what they feel they rightly deserve from your estate. One way to try to avoid future issues with an unloved one is to add a *no-contest clause* in your will. The no-contest clause, also called an *in terrorem clause* (note the word *terror* as part of the name!), basically says that if your unloved one contests what they were left, they receive — get ready for it — nothing! This is another reason that it's important to at least mention your unloved ones in your will.

TECHNICAL STUFF

No-contest clauses are not foolproof, however. Some states have enforceability restrictions on no-contest clauses if there is probable cause for someone to challenge your will. Nevertheless, it's a recommended clause to add to your will, if only as a deterrent for your unloved one to not contest your will.

Figuring Out Your Will Status

When you die, you have one of three *will statuses* depending on whether you have a complete valid will. Your will status may be

» **Testacy:** All your assets are covered by a valid will, and you're in pretty good shape.

» **Intestacy:** You die, and you don't have a valid will.

» **Partial intestacy:** The "no man's land" (or maybe purgatory?) when only some of your assets are covered by a valid will.

Testacy: When you've nailed everything down

If you have a valid will, you are said to die *testate.* Basically, you have spelled out your intentions completely and legally in your last will and testament and you have attained one of your two primary objectives of estate planning: control. (Your other primary estate-planning objective is protection.)

Not to sound like a commercial for a funeral home or life insurance policy, but when you die testate, you at least die with some peace of mind knowing that your wishes will be followed through, courtesy of the legal system.

Intestacy: When you die with zero "willpower"

Intestacy: the dark side! Being *intestate* means that you die without a valid will. Depending on your particular circumstances, the implications of your intestacy can be far-reaching. Most important, dying intestate results in your estate being distributed through the *laws of intestate succession* (commonly referred to as the *intestate law*) — a technical way of saying that the legal system decides how your estate is distributed. Essentially, your state writes a will for you — not an actual-on-paper physical will, but sort of a virtual will, made up of your state's default clauses that apply to the particulars of you, your family, and your estate.

Now, unfortunately, you have no say whatsoever in how your estate is distributed and who receives it. The intestate succession laws vary by state but are usually similar from one state to another in terms of the primary purpose: basically, to determine who receives your estate. The intestate law establishes a particular next-of-kin priority for distributing your estate. Did you have a spouse? Did you have children? What other relatives are in the picture?

WARNING

But what about other people — specifically, those people who aren't related to you — who you had wanted to take care of? Most likely, they're out of luck if you die intestate. Suppose, for example, you had wanted to leave $100,000 worth of Amazon stock to the family housekeeper who has been with you for years, and who even worked for your parents. Without your having a valid will specifying that desire — and, thus, being intestate — your housekeeper will most likely never receive anything from your estate. (Of course, whoever does wind up with that $100,000 worth of Amazon stock according to the intestate succession laws may later transfer that stock to the housekeeper, as you wanted, but don't count on it!)

WARNING

Also, if you don't have any living family members covered by the state's intestate laws, depending on the state where you live and your particular circumstances, the state's intestate laws could make your state your only beneficiary! Unless you really want to leave your estate to the state where you live, make sure you have a valid will so you don't die intestate!

Partial intestacy: When the vultures start circling

No man's land. Purgatory. Between a rock and a hard place. *Partial intestacy* — when part of your estate isn't covered by your valid will — is an in-between will status, not quite testacy but not quite intestacy either. Very often, forgetting to include a residuary clause (discussed earlier in this chapter) in your will is what causes you to be considered partially intestate when you die.

WARNING

If you've followed all the steps we discuss in this chapter and you've prepared your will, you may be tempted to think that you no longer have to worry about being intestate or partially intestate. Wrong! You may have overlooked some little item in your will that could negate your will completely if a disgruntled family member contests your will's validity.

The result, if that disgruntled person is successful: You may be *rendered* (basically, switched) into intestacy if your will is declared invalid, resulting in your estate being distributed through intestate succession laws — the one thing you wanted to avoid in the first place by having a will! Or you could forget to include the all-important residuary clause. What happens to your collection of 1930s-era baseball player autographs that you neglected to specifically bequeath to someone? Because you're intestate with regard to those autographs, they'll pass to your heirs at law under the intestate law.

TIP

Be sure to periodically consult with your attorney to make sure that your will is complete and current and has been properly signed and witnessed, and you'll increase the likelihood of your will status being testate (which is what you want).

IN THIS CHAPTER

» Understanding the laws that affect or interpret your will

» Grasping the laws that your will can change and what you must do about them

» Comprehending the laws that your will can't change

Chapter 4

Tied Hands and Helping Hands: What You Can and Can't Do with Your Will

We've slightly altered an old saying: "Where there's a will, there's all kinds of laws you need to worry about." (Well, it could be an old saying in legal circles, anyway.)

Even though your will provides you with a fantastic tool to direct what happens to your estate after you die, you don't exactly have a free hand in what you can make your will do for you. A number of state statutes affect or interpret your will and, consequently, the way you transfer assets to others. If you know what these laws provide, you can include appropriate language in your will to amplify or diminish the effect of those statutes.

In this chapter, we discuss those statutes. Keep in mind that because state law — not federal law — governs your will, some of the statutes we discuss in this chapter may not apply to you simply because of where you live. But because you're working with your attorney to create your will (see Chapter 3), don't worry — your attorney is well aware of the particular provisions that affect your will.

Making Your Peace with Statutes That Affect Your Will

Before you start grumbling about those laws or statutes that affect your will, remember that many of them protect your beneficiaries, particularly your spouse and children, so they're not necessarily bad for you and your estate. Think of these statutes as playing cards: You have to play the hand you're dealt, but if you really know your game, you can give yourself an advantage.

For example, what happens if your will specifically states that $100,000 must be left to each of your two children (a total of $200,000), but when you die, your estate is only valued at $150,000? A statute called the *abatement statute* (which we discuss in the next section) specifies what happens then.

After you die, who is responsible for paying any death tax that is due? Again, a statute is waiting in the wings to say exactly what will happen.

As you figure out what you want to write in your will (see Chapter 3 for a discussion about the basics of wills), you need to keep the list of the statutes we discuss in this chapter handy for easy reference.

TIP

Some statutes affecting or interpreting wills are complicated, especially when the fine print kicks in. Furthermore, the particulars of these statutes vary from one state to another, so you really need to work with your attorney when you prepare your will, rather than use a general fill-in-the-blank form that quite possibly doesn't address the impact of these statutes on your estate. If you do decide to make use of an online legal site to generate your own fill-in-the-blank form will, you should still run your near-finished will past a qualified estate-planning attorney to ensure that all state statutory requirements are met.

Identifying Statutes That Your Will Can Change

You can write your will in a certain way to address the following statutes:

- **Abatement statutes:** What happens when your estate isn't worth enough to provide what you want to leave your beneficiaries and to meet any debts you have remaining when you die?
- **Ademption statutes:** What happens if some of your property is missing when you die?
- **Anti-lapse statutes:** What happens if certain beneficiaries die before you?
- **Divorce statutes:** Well, these statutes are fairly self-explanatory.
- **Simultaneous death statutes:** What happens if you and someone else die at the same time?

Abatement: There's not enough in the cupboard for everyone

In Chapter 2, we discuss how you determine what your estate is worth, and in Chapter 3, we explain how you can use that information to specify in your will how much of your estate will go to various beneficiaries.

But what happens if you die and for whatever reason, your estate isn't worth enough to give everybody what you want them to get? Your state's *abatement statutes* come into play.

TECHNICAL STUFF

Abatement is defined as the process of reducing or lessening something, so you can think of abatement statutes as those laws that say, "Hold on, folks! Your estate doesn't have enough value to go around. Here's what we're going to do. . . ." Abatement statutes typically provide for a distribution priority in the event that the assets in your estate are not sufficient to pay all your creditors and to make a full distribution to each of the beneficiaries named in your will. The abatement statutes specify, for example, that property in your estate's *residue* (your "leftovers") may abate — that is, be reduced — before other property you specifically mention in your will.

Check with your attorney to determine how your particular state's abatement statutes work. However, if you're not satisfied with your state's statutory method of abatement, don't panic! Usually, you can make specific provisions in your will to specify how (and in what order) your assets should abate if your estate is not large enough to provide for the payment of all debts (including taxes) and to then carry out your directions for leaving specific dollar amounts or specific items to your beneficiaries.

REMEMBER

Your best strategy to avoid your estate being affected by your state's abatement statutes is to use percentage amounts rather than actual dollar amounts whenever possible in your will.

Suppose you calculate the value of your estate at $200,000, and you want to split that amount equally between your two children. One way to do so is to specifically state in your will that each child receives $100,000.

However, what happens if your estate doesn't grow at all and, instead, shrinks? Maybe some stock you own has declined significantly in value, or maybe you had a lot of medical expenses. Regardless, if your estate is now worth $150,000 and you haven't updated your will to reflect the reduced value of your estate, you have a problem!

But if you used percentage amounts rather than dollar amounts in your will, specifying that 50 percent of your estate goes to each child, you've avoided abatement statutes coming into play, even though your estate's value has decreased.

Abatement statutes can also come into play even if you have enough assets in your estate to cover specific dollar amounts you've specified for your beneficiaries, but you have outstanding debts that need to be settled when you die. For example, suppose you still have $200,000 worth of cash, stock, and other assets when you die, but you also have $50,000 outstanding on a variety of credit cards and other debts. Your estate isn't worth $200,000 at all, but rather $150,000 — your $200,000 in assets minus the $50,000 in debts.

Can't your family just, shall we say, forget about what you owe? After all, you're dead, right? Sorry. In the probate process (see Chapter 5), valid creditors' claims must be paid.

In Chapter 2, we mention that you need to tally up your debts, as well as your assets, when you're figuring out what your estate is worth. Don't forget — otherwise, you may be way off in your calculations of your estate's value compared with what your estate is really worth! Be sure to consider an estimate of probate costs (see Chapter 5) and death taxes (see Chapter 10) as parts of your estate's "debt," because those items will also diminish the amount of your estate that will be available to distribute to your beneficiaries.

But what happens if the way you write your will (typically, with specific dollar amounts used throughout) causes abatement statutes to apply to your estate? Basically, the abatement statutes determine how your will's property transfers to your beneficiaries will be reduced, and by how much. In the worst case, some of your property transfers may actually disappear due to the lack of funds available to pay them. That $25,000 to your cousin Jane? Sorry, the money is gone! But why?

State law, rather than federal law, regulates property transfers in wills. States greatly vary in the laws or statutes that affect these transfers. Some states follow the Uniform Probate Code (UPC) regarding wills. More than half of the states in the United States have adopted, in part or in whole, the UPC. The adoption of the UPC enables some uniformity of statutes among states, including abatement statutes.

TIP

In Chapter 1, we mention that one of the primary roles of your attorney on your estate-planning team is to help you with the "what if" scenarios and to help you prevent problems from occurring. When you're working with your attorney on your will, ask about the abatement statutes that apply in the state where you live, and what may happen to your property based on those statutes. And while you're asking, specifically question your attorney to help you prepare your will so abatement statutes won't come into play at all!

Ademption: Some property is missing

In Chapter 2, we mention that cataloging and valuing your tangible personal property (jewelry, antiques, collectibles, furniture, and so on) can be tedious and frustrating, but you need to take the time to do it as part of your estate planning.

In your will, you can explicitly leave items to someone through a *specific bequest.* For example, you can leave your valuable collection of '50s and '60s baseball cards to your baseball-crazy oldest son, and your collection of autographed first-edition novels to your other son, who is working on his PhD in English literature.

But what happens if you die and the baseball cards or the novels — or maybe both — are, for whatever reason, no longer part of your estate? You may have had to sell some of your property to pay for medical expenses. Or maybe you already gave your baseball cards to your son as a gift with the appropriate gift tax implications (see Chapter 11) while you were still alive, meaning that you've already transferred that property from your estate to his.

Regardless of the reason, if your will refers to property that isn't part of your estate when you die, that property is considered to be missing, or *adeemed,* and the *ademption statutes* apply.

TECHNICAL STUFF

Ademption statutes concern whether the specific asset in question is in existence when you die. In general, the statutes provide that your "who gets what" direction will fail if you aren't the owner of the asset when you die. However, you'll also find exceptions to the rule, which may apply in your case, including what happens if you dispose of an asset while incompetent (see Chapter 19) but receive another asset in exchange. Ask your attorney to walk you through the various scenarios that specifically relate to your estate's property.

Ademption statutes vary from state to state and determine whether the beneficiary who can't receive the specific bequest from your will is allowed to still receive something from your estate, and if so, what that beneficiary will receive.

So, what can you do to keep ademption statutes at bay? You can include *backup property* for some or all beneficiaries in your will. For example, you can specify that if your baseball card collection worth $50,000 is no longer part of your estate because you wound up selling all your cards on eBay, your son is to receive $50,000 in cash instead. Beware, though: Including backup property in your will can be complicated and have unintended side effects, so work carefully with your attorney on what backup property to use and the wording to use in your will.

Anti-lapse: Someone dies before you do

Anti-lapse sounds like a doddering old relative . . . you know, your "Aunty Lapse." Actually, anti-lapse is your situation when somebody named in your will dies before you do. To cover yourself, you should consider naming a *contingent beneficiary* (your backup beneficiary) for any property distribution in your will by including words such as the following:

> In the event that my named beneficiary for the property listed herein does not survive me, I hereby direct that that my bequest be given to John Doe.

If you don't make your own provisions for contingent beneficiaries, and if your state has an anti-lapse statute, that law dictates who receives the property that is in limbo because of your beneficiary who died. If your state doesn't have an anti-lapse statute, then typically the in-limbo property goes to the beneficiaries you name in your *residuary clause* (that statement names the beneficiaries who get anything you haven't explicitly mentioned in a giving clause). Sometimes, though, that is exactly what you want! Be sure to work with your attorney to determine if naming a contingent beneficiary makes sense.

Divorce: High noon at Splitsville

Nearly everyone has heard the statistic, again and again: Approximately half of all marriages end in divorce. With that large of a target audience, no wonder states have divorce statutes that you need to be aware of for your estate planning.

Your spouse automatically has a claim on part of your estate after you die. If you live in a common-law state (we cover this later in the chapter), your spouse is entitled to claim a percentage of your assets. If you live in a community-property state (we also cover this later in the chapter), your spouse generally owns half of your property.

WARNING

You may not want to change your will right away after you're divorced. For example, you may not have initiated the divorce and you subconsciously think that changing your will is equivalent to acknowledging that your marriage has ended. Therefore, estate-planning procrastination is a natural reaction for the recently divorced.

The good news: In many states, if your marriage has ended, but you resist changing your will to reflect this fact, your estate is protected from claims by your former spouse. The effect is that, typically, your ex isn't allowed to claim their share of your estate if you die after you're officially divorced but before you change your will. But be careful!

TIP

Even with the protection provided by such statutes, you still need to change your will as soon as possible after a divorce to clarify your intentions as to who your beneficiaries are. If your ex isn't one of them, make sure that's what your will reflects. Furthermore, you need to check on all your beneficiary designations that pass outside your will, such as life insurance. Be sure that any and all beneficiary designations are up-to-date, reflecting the beneficiaries you chose.

Simultaneous death: Sorry, but we have to talk about it

WARNING

Estate planning can sometimes be a depressing topic because it revolves around the subject of death, and the statutes dealing with simultaneous death are particularly depressing. However, you need to understand the implications to your estate from these statutes if you want to be as comprehensive as possible.

The simplest way to understand simultaneous death statutes is to consider the following situation:

- You and your spouse both die.
- The order of your deaths can't be established. (For example, you and your spouse both die in the same fatal car accident.)
- Your state law determines the order of death for inheritance purposes.

TECHNICAL STUFF

Most states have adopted a form of the Uniform Simultaneous Death Act to deal with simultaneous death situations. This act is based on the assumption that when the transfer of property is dependent on the order of death, the estate is distributed as if each person had survived the other person. For example, if a childless married couple dies in an accident, and for any assets not held jointly or that contain a beneficiary designation, the wife's estate is left to her relatives and the husband's estate is left to his relatives. Why? Because each person is assumed to have survived the other, the act treats the estate distribution as if the other spouse had already passed away, which is actually good news (if you can consider any news in this type of situation as "good"). The same assets don't pass through probate twice (once for each spouse), quite possibly subjecting the estate to double estate taxation and twice as much complication. (See Chapter 5 for more on probate.)

To be on the safe side, include a *survival clause* in your will to either confirm or change your state's version of the Uniform Simultaneous Death Act, according to what you and your attorney decide makes sense for you.

A survival clause is important in "closely related death" (though not simultaneous death) situations. You effectively "void out" a directive you had made in your will to leave property to someone if that person dies very soon after you do.

WARNING

For example, suppose the same childless couple is critically injured in an accident, but one spouse dies five days before the other. Without a survival clause, property from the spouse who dies first transfers to the surviving spouse and goes through probate, possibly being subjected to death taxes. When the other spouse dies only a few days later, that very same property can once again be subjected to estate taxes. In effect, the estate goes through double taxation that wouldn't have occurred if that couple had died simultaneously.

TECHNICAL STUFF

Typically, however, in most states that have an inheritance or estate tax, when assets pass from one spouse to the surviving spouse, a tax is not imposed.

To help prevent these complications, specify in your will that your beneficiary must survive for some period of time — 30 or 60 days, for example — after your death before receiving the assets you've specified in your will. If that beneficiary dies very soon after you do, your property will skip over that person and go to someone else, avoiding double probate and possibly double estate taxation.

Living (and Dying) with the Laws That Your Will Can't Change

WARNING

If you prepare a will that conflicts with certain statutes, you risk spending a lot of time and effort only to find out that you've created a will that may not be effective or valid. If, for some reason, you decide to treat your will and your estate like a bad soap opera plot and leave as little as possible to your spouse and children (possibly leaving them in serious financial trouble), your state's statutes may come to the rescue and provide some amount of financial protection for your family.

But even if you aren't deliberately and maliciously trying to hurt your family with what you specify in your will, you still need to be aware of what your state's laws say about what may happen with your estate. Otherwise, you face the very real possibility of preparing what you think is a valid will, but because you've accidentally run aground of one or more of your state's statutes, your will isn't valid at all.

So, read through the following descriptions of statutes so you know what you're dealing with.

Community property

If you live in a community-property state, any property acquired and any income made while you're married is considered to be owned 50 percent by you and 50 percent by your spouse. More important for estate-planning purposes, you're required under those states' *community-property statutes* to leave half of your community property to your spouse.

TECHNICAL STUFF

Eight states are community property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington. Wisconsin has a system similar to community property called *marital property,* and for purposes of our discussion, we lump Wisconsin in with the other eight community-property states.

If you live in a community-property state, all property acquired while you're married is considered community property except for property that you personally receive by a gift or by inheritance, which is considered to be your sole and separate property. For example, your grandmother's inherited wedding ring or the $10,000 cash gift from your aunt to you isn't part of your community property. Additionally, property you owned before you were married is also exempt from being included in community property.

A COMPLICATED COMMUNITY

Community-property laws can be very complicated. For example, property you own before you marry in a community-property state is still considered to be your own. However, income you earn on your own property after you're married may be considered to be community property. For example, if you inherit a farm from your parents before you get married, and then you marry and live in a community-property state, income from that farm may be considered to be community property.

Additionally, you need to be aware of what happens to your estate if you married in a community-property state but later moved to a non-community-property state, or if you purchased investment property in a community-property state but live elsewhere.

You absolutely need to consult with your attorney to see if community-property statutes apply to any part of your estate, and if so, what those statutes mean to your estate.

WARNING

Keep your non-community property separate from your community property! You can actually override the "separate stuff" aspect of your non-community property by specifying in writing that you want that property (again, a gift or inheritance) to become part of your community property with your spouse, or by intermixing your non-community property and your community property (for example, by putting your $10,000 cash gift from your aunt into a joint savings account you and your spouse share). If you turn your non-community property into community property, either accidentally or on purpose, you lose your sole control over that property, and the community property statutes take over.

Common-law property and spousal elective shares

What if you reside in one of the other 41 states that aren't community-property states? You live in a common-law state, and your spouse still has a claim to some part of your estate, though not the automatic 50 percent specified by community-property statutes. In almost all common-law states, your spouse is provided for through *spousal elective shares*, or the law that permits your spouse to claim some part of your estate.

If you live in Alaska, Florida, Kentucky, South Dakota, or Tennessee, you can elect to opt into a community-property system. You can also identify specific assets to be community property. In three states — California, Nevada, and Washington — domestic partnerships must also legally operate under community-property laws.

TECHNICAL STUFF

A few other states — Arkansas, Kentucky, and Ohio — use the old English concepts called *dower* and *curtesy*, which we discuss in the section "Homestead allowance: Keeping a house for kiddies and spouse," in this chapter. In all other common-law states, spousal elective shares have replaced dower and curtesy.

Your spouse has the right under spousal elective shares to claim a portion of your estate, with the amount depending on your own state's spousal elective shares statutes. But what about your will? Spousal elective shares are sort of like flipping a coin and calling "Heads, I win, and tails, I win, too."

Your spouse basically gets a choice between accepting the amount you specified in your will or the amount specified in your state's spousal elective shares. If your will specifies that your spouse is to receive more than your state's spousal elective shares specify, then your spouse can accept that higher amount. But if your will specifies a lower amount than your state's spousal elective shares, your spouse can opt for the higher amount specified by law. In doing so, your spouse can cause all kinds of complications to your will.

Spousal elective share amounts vary among states. Under some statutes, your spouse's share is a percentage amount that ranges from 3 percent to 50 percent of your estate, based on how long you were married. Other states' statutes specify an amount equal to some flat percentage of your estate regardless of how long you were married.

TECHNICAL STUFF

In some states, spousal elective shares are based on an *augmented estate* amount rather than your actual estate amount. Basically, certain property that isn't technically part of your estate is added back to your estate's value, and the spousal elective percentage amount is based on this higher, augmented value rather than on your estate's actual value at the time of your death. What's the deal? States that use augmented estate amounts are trying to protect a surviving spouse from that person's husband or wife deliberately trying to reduce the value of an estate and leaving as little as possible to the surviving spouse.

For example, property transfers that you made within a certain period of time before your death may be added back to your estate, along with certain property in which you have ownership with right of survivorship (see Chapter 6) and sometimes life insurance proceeds, retirement benefits, and annuities. When you work with your attorney to understand the spousal elective share laws in your estate, make sure that you also ask if augmented amounts apply to your estate.

WARNING

If you really don't like your spouse, don't use your estate plan to try to punish them by trying not to leave them anything as part of your estate. Your estate-planning attorney isn't the person you should be working with on this problem; try a marriage counselor, or if that doesn't work, ask your estate-planning attorney for a recommendation for a good divorce attorney! Don't complicate or even trash your estate planning by trying to give your spouse a raw deal and make some kind of point. Your entire estate plan may be defeated if your spouse makes that spousal election after your death!

Homestead allowance: Keeping a house for kiddies and spouse

Just as Dorothy discovered in *The Wizard of Oz*, there's no place like home. So, you definitely want your home to be protected after you die. Fortunately, the *homestead-allowance statutes* may take care of your home. Unfortunately, though, only a few states have these statutes.

The purpose of homestead-allowance statutes is to make sure that your spouse and any minor children (under 18 years of age) have a place to live after you die. Your homestead is typically defined as your house and may also include a certain amount of adjacent land. (The legal term you may run across is *curtilage.*) The land aspect of homestead allowances is very important if you live on a farm or any property with a large number of acres.

TECHNICAL STUFF

Homestead-allowance statutes come from the old English common law concepts of *dower* and *curtesy*, and you may come across those terms. (We mention in an earlier section that Arkansas, Kentucky, and Ohio laws use dower and curtesy rather than spousal elective shares or community-property statutes.) The purpose of dower and curtesy was to provide a surviving spouse with an interest for the remainder of their life in the real property owned by the spouse who died and, therefore, have somewhere to live. *Dower* is the word used for a wife's interest, while *curtesy* refers to a husband's interest.

Homestead exemption: How the law protects your house from your creditors

Homestead-exemption statutes are closely related to homestead-allowance statutes and apply if your estate needs to pay debts you owe to creditors. If not enough cash is available, the estate is forced to sell off property — real, personal, or perhaps both — to get enough money to pay the creditors. If your estate owes a lot of money for debts, selling off a single high-value item, such as your house, is often easier than trying to sell a lot of smaller items.

So, the homestead-exemption statutes are intended to prevent your surviving spouse and minor children from being kicked out of your home if property does need to be sold to pay creditors.

WARNING

Even with homestead-exemption statutes, your home can still be subject to a forced sale. Think of these statutes simply as a first line of defense rather than an absolutely 100 percent guarantee that your spouse and children can remain in your home if your estate owes a lot of money and that money can't be raised by selling other property from the estate. Therefore, you need to consider the other parts of your overall estate planning, such as life insurance, to help out the homestead-exemption statutes and protect your family and your home.

Exempt property: How the law protects your personal property from creditors

Your estate is composed of various types of property: real property and personal property, including both tangible personal property and intangible personal property.

The two types of homestead statutes that we discuss earlier — homestead allowance and homestead exemption — help to protect part of your real property (your home). However, the vast majority of your intangible personal property (stocks, bonds, and so on) isn't covered by protective statutes and, therefore, may be forcibly sold to satisfy claims from your estate's creditors.

The good news: Some of your tangible personal property (your car, collectibles, jewelry, and so forth) may be protected through *exempt-property award statutes.*

With the homestead statutes, exempt-property award statutes vary among states so you need to talk with your attorney about what types of tangible personal property your state's statutes protect, and how that relates to your estate plan.

Family allowance: Drawing from your estate to protect your family

Your spouse and children may rely on you as the family's breadwinner. And even if you aren't the sole breadwinner, the income you provide to your family may provide a substantial portion of basic care, such as food and shelter, for your family. Therefore, your unanticipated death will often create an immediate financial crisis for your family. But you have several assets, and your will specifies what goes to your family, so you don't have this problem, right?

WARNING

Not necessarily! Your estate may be tied up in the probate process (see Chapter 5) for an extended period of time. Typically, your estate can't make any distributions to your beneficiaries until all debts to your creditors have been paid. Therefore, your family's immediate financial needs, such as the mortgage payment and even paying for utilities and food, may be in jeopardy!

Fortunately, *family-allowance statutes* enable the probate court to provide money for support of your spouse and minor children during the probate process. In fact, family-allowance statutes are one of the only distributions that can be made from your estate without risk before the claims of your creditors are paid.

TIP

The amount of your family's allowance under your state's law may depend on a number of factors, including your estate's size and your family's living expenses. Ask your attorney to inform you what the allowance likely is so you can factor that into your overall estate plan. For example, you may want to set up your gift-giving strategy to transfer cash to your beneficiaries (while you're alive) so they can use it to help cover living expenses during the probate process.

Oops! Taking care of VIPs who aren't in the will

REMEMBER

You must continually update your will as circumstances in your life change, particularly when you get married, give birth, or adopt.

But suppose you get married or have a child and you don't update your will before you die. Are family members who aren't mentioned in your will totally out of the picture when your estate is distributed? (In legal-speak, a spouse or child not included in your estate is called a *pretermitted* or *omitted* heir or beneficiary.)

Pretermitted- or *omitted-heir statutes* help to protect certain family members that you don't mention in your will, but they only apply to your spouse and children. These statutes, which (as you probably expect us to say) vary from one state to another, govern what part of your estate must go to your spouse and children if you procrastinate and don't keep your will up-to-date.

IN THIS CHAPTER

» Understanding how probate works

» Revealing the good, the bad, and the ugly of probate

» Making probate easier — in some cases

» Selecting your personal representative

» Becoming someone's personal representative

Chapter 5

Probate: Top of the Ninth Inning for Your Estate

Dealing with probate may sound like you've just been sprung from jail and have to walk a straight and narrow path for a while. Actually, that's *probation,* a word that also means "to prove," like when you call Officer Krupke and reassure him you've left your criminal past behind.

Probate, on the other hand, is what happens to your estate after you die. Like probation, probate works through the legal system. It's probably the most misunderstood aspect of estate planning. However, probate is, in some ways, the most important part of the entire process because, at the conclusion of probate, all your planning has been put into action, your estate property has been used to pay your debts at the time of your death, what's left has been distributed to your heirs, and an official record sits at the court documenting everything.

Fear not! This chapter covers the probate process, including both positive and negative aspects of probate, as well as alternative forms of probate. We also suggest a sensible process for selecting your *personal representative*, the person you name in your will who takes charge of your affairs after you've left the scene.

Probing Probate: What You Should Know

Probate is a term that is used in several different ways. *Probate* can refer to the act of presenting a will to a court officer for filing — such as, to "probate" a will. But in a more general sense, *probate* refers to the method by which your estate is administered and processed through the legal system after you die.

The probate process helps you transfer your estate in an orderly and supervised manner. Your estate must be disbursed in a certain manner — your debts and taxes paid before your beneficiaries receive their inheritance, for example. Think of the probate process as the "script" that guides the orderly transfer of your estate according to the rules.

TECHNICAL STUFF

You may ask where these rules come from. Good question! The answer is, in short, the law. Without droning on and on about how our laws came to be, suffice it to say that the laws regarding probate originated from laws written by your state government over the many years since your state came into existence. Most of these written laws are actually documentation of what previously were unwritten rules set by a king or governor even before states existed. In the very old days, when someone died, the family would request approval from the king or his assistants to divide property between the remaining family, usually based on how closely related the family members were. For example, the oldest son may have received the most farmland, cows, or whatever it was the deceased person owned.

Many people think that probate applies to you only if you have a will. Wrong! Your estate will be probated regardless of whether you have a will. Here's how it differs:

- **With a valid will:** If you have a valid will, your will determines how your estate is transferred during probate and to whom.
- **Without a valid will:** If you don't have a valid will, or if you die *partially intestate,* where only part of your estate is covered by a valid will (see Chapter 3), the laws of the state where you reside specify who gets what parts of your estate.

Read on for a few important points about probate you need to know.

The probate process

Even though you won't be around when your estate goes through probate (after all, you'll be dead), you need to understand how the probate process works. At the most basic levels, the probate process involves four basic steps:

1. Identify and document all the property you own.
2. Preserve that property until it is accurately distributed to your beneficiaries.
3. Pays debts you owe, including taxes that your estate will owe.
4. Transfers assets to your beneficiaries.

A state court called the *probate court* oversees the probate process. Because probate courts are state courts and not federal courts, the processes they follow may vary from one state to another. Yet despite their differences, these courts all pretty much follow the same basic processes and steps, which typically include

- Swearing in your personal representative
- Notifying heirs, creditors, and the public that you are, indeed, dead
- Inventorying your property
- Distributing your estate (including paying bills and any taxes)

Swearing in your personal representative

In your will (see Chapter 3), you name who you want to be your *personal representative* (the person in charge of your estate after you die). However, the court determines the personal representative for your estate under the following circumstances:

- You die without a will.
- You have a will but for some reason didn't specify who you want to be your personal representative.
- The person you selected has died or for some reason can't serve and you didn't "bring in someone from the bullpen" to replace your original choice.

A family member, such as your spouse or an adult child, can request that the court appoint them as the personal representative for your estate. Regardless of who is finally selected, the court gives your personal representative official rights to handle your estate's affairs. As evidence that this person has the authority to act on behalf of your estate, the court gives your personal representative a certified document called the *letters of administration* or *letters testamentary.*

In either case, the personal representative named in your will or determined by the court has to first be formally appointed by the court before officially *entering into office* (the term that's used). Usually the personal representative must take an oath of office, after which they'll receive the official documentation showing their status (the letters of administration or letters testamentary we mention earlier).

Your personal representative files a document called a *petition for probate of will and appointment of personal representative* with the probate court, which, along with the death certificate (just to be safe), gets the process officially started. This petition begins the probate process. If you have a will, the probate court issues an order admitting your will to probate. Basically, the court acknowledges your will's validity and officially allows the aforementioned personal representative to act on your estate's behalf.

Notifying heirs, creditors, and the public

Some state laws require your personal representative to publish a death notice in your local paper. The death notice serves as a public notice of your estate's probate and enables people who think they have an interest in your estate (such as creditors) to file a claim against your estate within a specified time period.

The notice is part of the process to make the matters of your estate part of the public record. Some people view the general public's ability to review your private estate matters as one of probate's disadvantages, as we discuss in "Probate: The bad and downright ugly side," later in this chapter.

Inventorying your property

The personal representative must inventory the different types of property — real and personal — that make up your estate so your estate value can be determined. This inventory is important for a couple of reasons:

- **To make sure you left enough to cover your debts and distributions to beneficiaries:** If your estate doesn't meet the monetary obligations of both your estate creditors and your property transfers to your beneficiaries, it's subject to *abatement statutes* (see Chapter 4), meaning that one or more beneficiaries may receive less than you had wanted or even nothing at all. Covering your debts is important because, although we wish that when we died everything we owed just went away, that just isn't the case. Maybe as a last fun fling when you realized you're nearing death you go out and buy that luxury car you've always wanted. Well, if you took out a loan to buy it, your estate will have to pay it off after you die. The same is true for any taxes you didn't pay before your death. You may have heard the expression that two of the only certainties in life are death and taxes. If you die before you've paid all your income taxes for the year, your estate must file and pay one last tax return after you've died. (We address that issue a little later in this chapter.)

- **To ensure that all property is accounted for.** Your personal representative is in charge of collecting and inventorying your estate's assets to make sure that all property is available for distributing at the end of the probate process. (Your beneficiaries, of course, will want to know what assets are in your estate.) If property is missing or not in your ownership at the time of your death, *ademption statutes* (see Chapter 4) become relevant. These statutes determine if a replacement asset or cash equivalent should replace the missing property intended for your beneficiary.

TIP

You should already have a pretty good idea of what your estate is worth (see Chapter 2) so you can make intelligent choices for your estate plan. Obviously, your personal representative needs to know this information, too. So, make sure that your personal representative has easy access to the list that shows what your estate includes and what your assets are worth. Even a slightly out-of-date list can serve as a starting point so your personal representative doesn't have to create an inventory from scratch.

Distributing your estate

The final step in the probate process is the distribution of your estate property. In other words, ideally everyone — your creditors and your heirs — gets what's coming to them.

Creditors who have a valid claim are likely to be paid in the following order (though the order varies from state to state):

1. Funeral expenses (burial or cremation and other final expenses such as a memorial service (provided you were well liked enough to deserve one)
2. Cost of medical care prior to death
3. Family allowances (see Chapter 4)
4. Taxes and debts (such as credit cards and automobile loans)
5. All remaining claims

Whatever's left after your creditors get their money is distributed to your heirs or to the beneficiaries you named in your will. If you died without a will, the laws in your state determine how your property is distributed.

If probate proceeds according to plan and all notices and communications are properly handled, your personal representative is usually protected against any subsequent, late-arriving claims. Your personal representative will be protected after some specified time period expires.

Some complicating factors to the probate process

Some probate processes can be relatively straightforward, while others can be particularly complicated depending on how complicated an estate is. The following sections describe some of the more common complicating factors about probate that you're likely to encounter.

What's probated where: Differences between states

All states have probate, and all the types of property that make up your estate — real and personal — may be part of your estate's probate. Tangible and intangible personal property, like your collectibles and your stock portfolio, are probated in the state where you live, but your real property (your primary home and other real estate, as we discuss in Chapter 1) is probated where the property is actually located. So, if you live on a farm in Pennsylvania and also have a vacation condo in Florida, you'll have two probates: Pennsylvania probate for your farm and your personal property, and Florida probate for your condo.

If you have more than one probate, the additional probate is called an *ancillary probate.* Ancillary probate can be costly because your personal representative usually needs to hire an attorney in the state where the real property is located to handle the ancillary administration of probate.

Here's some good news, though: In many cases, the second state's courts will legally recognize your personal representative's authority, and they can act on your estate's behalf in the second state without the necessity of a duplicate probate proceeding. The biggest headache in this situation may be the time and cost of traveling back and forth, which, fortunately, is a cost of probate, so it will, in most instances, be paid from your estate money after your death.

TECHNICAL STUFF

UPC STATES VERSUS NON-UPC STATES

Probate varies among states that subscribe to the Uniform Probate Code (UPC) and those states that don't. The probate process is more formal in non-UPC states. The administration in UPC states tends to be more flexible by offering different options regarding the amount of court supervision in the probate process. These options include complete court supervision, no court supervision, or a combination of supervision that falls somewhere between the first two alternatives. Find out whether your state follows the UPC so you can determine the available options for your estate's probate and your personal representative.

SOME MORE LEGAL-SPEAK FOR YOU

If you do specify someone in your will to be your personal representative and to handle your estate, that person is often called the *executor* if male or *executrix* if female. If, however, you do not have a will, the personal representative can be called an *administrator* if male or *administratrix* if female. However, the term *personal representative* can be used whether you have a will or not and is a generic term referring to the person in charge of your estate.

Probate or not: Differences between types of property

Another common misconception is that probate applies to all of your estate. Actually, probate handles the processing of all assets in your *probate estate.* Your probate estate is made up of all the property that's distributed through probate; the remaining property is called *nonprobate property.*

TECHNICAL STUFF

In a general sense, probate assets are those you own alone, while you own nonprobate assets jointly with others, to whom those assets will pass automatically upon your death. Nonprobate assets also include assets that pass to a named beneficiary: bank accounts, life insurance policies, and retirement accounts, for example. Because these nonprobate assets pass to someone automatically, there is no need for probate.

Nonprobate property is your estate's way of saying (well, if your estate could talk), "No, thank you, Mr. Probate. I can handle this part myself!" Nonprobate property includes *will substitutes,* such as joint tenancy with right of survivorship and living trusts (see Chapter 6). Other assets, such as life insurance proceeds, qualified retirement plan benefits, and individual retirement accounts (IRAs) with named beneficiaries (see Chapter 18) are also included.

Knowing the Good, the Bad, and the Ugly of Probate

Be aware of both the positive and negative aspects of probate. Know the pros and cons when you're planning your estate. You need to determine which assets will require probate and which assets should be nonprobate assets and pass to others through a will substitute. As we explain earlier, assets like bank accounts, mutual funds, and life insurance may name a specific person to receive the balance of these accounts after you die. This means your executor needs to handle fewer things in the estate. So, make sure you ask the financial institution if you can name a beneficiary for your account after you die. The financial institution will give you forms to sign to do this.

Probate: The good side

The positive aspects of the probate process include the following:

- **Fairness:** The probate court's independent role allows for an objective processing of your estate. The probate court regulates all parties involved in the process to make sure that everyone is treated fairly. For example, the fees paid to attorneys, appraisers, or any other outside parties must be fair and reasonable before they can be paid from your estate. In fact, many states have laws specifying attorney fee maximums as a percentage of the total value of the estate.
- **Defined procedures:** The probate process provides an orderly administration of your estate and guarantees that the probate court will correctly transfer your estate's property. These procedures have specific deadlines that help ensure that everyone involved is kept on track and held accountable. If deadlines are missed, court employees may ask a judge to order things to happen that did not.
- **Protection:** The probate process allows creditors that have valid claims to receive what they're rightfully owed from your estate by proving the validity of their claims. If mechanisms weren't in place requiring creditors to prove the validity of their claims, your estate could be subject to fraudulent claims.

  Imagine a sleazy finance company calling a grieving surviving spouse two days after a funeral and claiming that a loan payment of $5,000 is now two days overdue, but if the payment is made that day by certified check, no late charges will be applied. By requiring creditors to go through the probate process, your estate is mostly protected from these types of fraudulent claims.
- **Potential tax savings:** If your estate is in a lower income tax bracket than the beneficiaries who receive the property transfers, tax savings may occur from lower income tax rates. (We explain more about tax implications in Chapter 10.) Income tax savings are dependent on current tax rates and, thus, may not always be advantageous.

  TIP

  Don't forget that many probate costs are tax deductible and, therefore, may also reduce death taxes.

Probate: The bad and downright ugly side

Although the positive aspects present a good case for probate, several negative aspects can make probate an unpleasant process. The negative aspects of probate include the following:

- **A complicated process:** The probate process can cause almost anyone to throw their hands toward the heavens and yell "Noooooo!" Multiple, often complicated steps are required before your property transfers can occur. In most states certain parties get paid first — like the hospital that took care of you or the funeral home or crematory that took care of your body after you died. The process often requires numerous hearings and professional assistance — for example, from appraisers to determine value and attorneys simply to get through the process.
- **A lack of privacy:** Probate and privacy are polar opposites — the only thing in common is that both words begin with the letter *p.* Privacy typically doesn't exist in the probate process because after your will is probated, your will becomes a part of the public record. Additionally, your estate's inventory and inheritance tax return (if applicable) also become parts of the public record. Anyone then can see what your will and estate contain. ("Wow! I didn't know that John had so much money! Let's try to sell his widow all kinds of shady investments!") However, some states may offer additional means of privacy for the probate process, so check with your attorney to understand what your estate will go through some day.

  Many people consider their own financial situation, including what their estate contains, to be a private matter. On the other hand, you may not be a private person or you may figure that after you're dead, you really don't care about the lack of privacy. In this case, the negative aspect of lack of privacy becomes irrelevant.
- **Costs:** Everything in life comes with a price. And this old adage applies even in death: Even after you're gone, the probate process is going to cost your family (or beneficiaries).

  Your personal representative is entitled to reasonable compensation that typically ranges between 2 percent and 5 percent of your gross estate. Your personal representative also has the option of waiving the fee and may want to do so for income tax reasons. You may consider a family member or trusted friend as your personal representative if you know that person will waive the fee, as long as you feel that person is qualified to serve.

  Attorneys are also entitled to a reasonable fee that also may range between 2 percent and 5 percent of the gross estate but may vary depending on factors such as the complexity of the estate, the attorney's time spent settling the estate, the attorney's experience, and other factors. If you add other costs like ancillary probate costs for real property located in another state, the costs of probate add up quickly!

AN EARLY PAYOUT

Depending on your state law and the particulars of your estate, your personal representative may actually be able to distribute part — or even most — of your estate to your beneficiaries earlier in the probate process than otherwise would be done through a *risk distribution.* Your personal representative should work with your attorney and accountant to see if doing so is permissible and advisable and to proceed with caution.

- **An often-lengthy process:** Probate may be an orderly and defined process, but probate is anything but fast! The probate process for an uncontested will — meaning no one comes forward to say they have an issue with your will — can easily take 6 to 24 months. And if your will is contested, the process can be even longer, often years longer.

  Typically, your beneficiaries can't receive any property transfers until all the valid creditors' claims and taxes have been paid (see the sidebar, "An early payout"). While your beneficiaries await the completion of your estate's probate, your estate's value may decline — maybe even significantly (think bear market and declining stock prices or a real estate market crash) — leaving your beneficiaries with a lot less than they would've received if the probate process were faster.

Streamlining the Probate Process

The legal system hasn't failed to notice the negative aspects of probate. Probate courts and personal representatives everywhere face the costly, timely, lengthy, and complicated process again and again.

In response to the drawbacks of the probate process, several alternatives may be available for smaller estates. Some states have attempted to simplify the process with streamlined versions of probate. ***Remember:*** You can't avoid probate with your will, but these alternatives attempt to improve the process. (Hey, every little bit helps!)

TECHNICAL STUFF

In your state, you may come across terms such as *probate affidavit, summary probate,* or *small estate affidavit* that describe your state's alternatives to its formal probate process. Some of these probate alternatives have a cutoff amount that your estate would need to be under (that is, worth less than the specified dollar amount cutoff) for your estate to be eligible to use that particular alternative. A good example is a provision in Pennsylvania law that allows certain next of kin to claim up to about $10,000 of a bank account with only a funeral bill, an affidavit, and a death certificate. Your attorney can advise you what alternatives are available in your state, if your estate qualifies for one or more of those alternatives, and whether one of those alternatives makes sense for your estate.

Appointing Your Personal Representative

Choose carefully! Your personal representative plays the central role in your estate's administration.

The appointment of your personal representative (and a contingent personal representative as a backup person) is one of the most important actions in your will. Your estate represents your lifetime of work. You, basically, are your own personal representative while you're alive, but after your death, you need to have someone watch over your estate and make sure that your wishes are carried out. Your personal representative performs this function.

If you don't designate a personal representative, the probate court may appoint someone for you one way or another. So, whether you have a will or not, someone is appointed to handle your estate administration.

Identifying your personal representative's role

Before you choose someone as your personal representative, double-check that the person understands their responsibilities. For that matter, you need to be aware of your personal representative's responsibilities so you can select the most appropriate person.

The personal representative follows a *critical path method* — a road map of the most efficient way to proceed — in the administering of your estate. The steps of the critical path are:

1. Collecting and inventorying estate property
2. Managing estate property
3. Processing creditors' claims
4. Filing tax returns and paying taxes
5. Distributing estate property

We cover all of these steps in the following sections.

Collecting and inventorying estate property

Your personal representative first must locate your assets and see what you have in your estate for distribution. Think of this part of your personal representative's responsibilities as the same as the objective of an Easter egg hunt: to find the eggs and put them in a basket or, in this case, find and gather together all your property (sorry, no chocolate-filled treats here).

When collecting and inventorying your assets, your personal representative must notify banks and companies where you have investments that you have died, change the address of record on your accounts, and make sure all future communication is through the personal representative. Additionally, your personal representative may need to hire an appraiser to determine your property's fair market value.

Your personal representative also serves as your accounts receivable coordinator. They collect all amounts owed to you, such as your final paycheck, rent from an investment property or payments from a note or loan. If your estate is still responsible for what you owe to others after you died, you certainly want to make sure that all amounts owed to you will still come into your estate. You're not letting anyone off the hook for what's owed to you!

Your personal representative also collects payments you're due and entitled to receive from Social Security (but must also return any inadvertent payments from Social Security after your death) and any life insurance proceeds, if the proceeds are payable to your estate. (See Chapter 17 for a discussion of life insurance and your estate.)

Your personal representative must transfer all receivables and any other *liquid* part of your estate (readily available assets, such as cash on hand or amounts contained in your bank accounts) to an account that they control. Through this account, your personal representative pays valid creditors' claims, fees, taxes, and cash bequests to your beneficiaries after approved by the probate court.

WARNING

Your personal representative needs to be careful not to commingle estate assets with their own, so they must use a separate bank account.

Managing estate property

Because probate doesn't happen overnight and can drag on for months (or even years in the worst-case scenario), your personal representative manages your estate during the entire probate process. They keep an eye on your estate and its contents until the assets are transferred to your heirs or beneficiaries. Managing your estate includes

- Supervising property
- Maintaining property
- Insuring property
- Securing property

For example, if your estate has income-producing investment property, such as a rental house or apartment, the personal representative must manage the property or retain a property management company.

The personal representative needs to insure both real property and tangible personal property (such as jewelry and household furnishings) against loss until the property is transferred to your beneficiaries. Some of your estate property likely had sentimental value to you and to the beneficiary you intended to receive the property. In addition to insurance, your personal representative should physically secure your property to prevent any theft or damage.

Processing creditors' claims

One of your personal representative's major tasks is the processing of creditors' claims. Typically, creditors have a specified period (varying from state to state) to file their claims or they lose their ability to receive a part of the estate. Because creditors must typically be paid before any property transfers can occur to beneficiaries, processing creditors' claims is an important function of the personal representative in order to keep an already lengthy process moving along.

The personal representative provides notice to creditors of your death by delivering specific notices to the creditors or by general public notice through the newspaper. The notice includes information such as

- The case or file number assigned by the probate court
- The probate court's location
- The personal representative's contact information
- The due date for filing a claim
- Documentation needed to process the claim

The personal representative must determine which creditors' claims are valid — sort of like being one of the celebrity panelists on the old game show *To Tell the Truth.* If a creditor's claim is valid and filed within the required time period, the personal representative pays the claim from estate assets. (In fact, sometimes the personal representative must turn to the court to decide whether a claim is valid.)

Filing tax returns and paying taxes

Your personal representative must pay all taxes associated with your estate. Taxes can include any of the following that apply to your estate (see Chapter 10):

- Federal estate taxes
- State inheritance and estate taxes
- Federal, state, and local income taxes
- Gift tax
- Generation-skipping tax

TIP

Feeling overwhelmed and a little bit guilty about what you're leaving your personal representative to do? Don't! Typically, one of your estate-planning team members — your accountant — actually prepares and files all the tax returns. But your personal representative is ultimately responsible for making sure all taxes are paid.

Many of the tax returns have filing date deadlines that are triggered by your date of death. Your personal representative needs to keep track of these deadlines, which means they must be organized. We discuss the important characteristics to look for when choosing your personal representative in the section "Deciding who's eligible to be your personal representative," later in this chapter.

Distributing estate property

The final step for your personal representative is your estate's actual distribution. If you have a will (and hopefully you do!), your assets are distributed to your beneficiaries. If you don't have a will or your will lacks a *residuary clause* (the clause in your will to deal with whatever property you don't specifically mention in a giving clause, as we discuss in Chapter 3) so that some of your assets don't have a beneficiary named, your personal representative distributes the assets in accordance with your state's intestate succession laws.

Even if you have a will, your estate distribution can be affected by other statutes (see Chapter 4). Your personal representative follows the statutes' requirements when distributing your estate assets, such as spousal elective shares, homestead statutes, and exempt property awards.

Real property is transferred to your beneficiaries by a deed evidencing legal ownership. Personal property is transferred by either an assignment document to the beneficiary or a certificate of title if appropriate (for example, a vehicle). For cash distribution, the personal representative provides a check on the estate account payable to your named beneficiary. The property transfers complete the role of your personal representative. The heirs or beneficiaries generally provide receipts as evidence of the distributions, thus releasing the estate and personal representative.

Deciding who's eligible to be your personal representative

So, now you know what your personal representative does in administering your estate. But who can be your personal representative? Your personal representative can be practically anyone but usually is one of the following:

- Family member
- Friend
- Business associate
- Attorney
- Corporate executor (from a bank, for example)

You have a relationship with all these people. The corporate executor is typically a financial institution that you have a financial relationship with, like the trust department of a bank.

Now, who do you choose? You know their responsibilities as your personal representative. The person — or institution — you select must possess certain characteristics that are needed to perform their duties, such as:

- Trustworthiness
- Honesty
- Dependability
- Organization skills
- Common-sense judgment
- Fairness
- Geographical proximity to the probate court and your property

Your personal representative needs these characteristics in order to properly administer your estate. For example, your personal representative needs to be fair because one of the hats the personal representative wears is often as a referee to settle disputes that can arise in your estate.

Geographical proximity to your estate property and the probate court is helpful in your estate's administration. (Long-distance relationships are difficult enough when you're alive and even more complicated when you're dead!)

Okay, so you look around and see many choices. (On the other hand, you may think: "If these are my choices, I'm in trouble!") Many people choose their spouse as their personal representative. After all, you've just spent a lifetime (or your spouse has just made it seem like a lifetime) with your spouse and who knows you better? Besides, your spouse most likely is receiving the largest part of your estate.

But the job is time-consuming and tedious. Make sure your spouse and anyone else you're considering understands what's expected. If you have a somewhat complex estate that involves numerous beneficiaries and creditors, inform your personal representative and obtain their consent in advance to serve on behalf of your estate. Make sure they know what they're in for!

Avoiding the pitfalls

WARNING

You need to be aware of several potential pitfalls when selecting your personal representative, including the following:

- Being perceived as favoring one family member over another
- Keeping your business going (if applicable to your situation)

If you have three adult children, all about the same age and equally well off financially, you run the risk of slighting two of those children if you select the other as your personal representative. Never mind that pretty much anyone who has ever served as a personal representative agrees that the job is basically one of dealing with details and complications — and plenty of aggravation — for months on end. The other children may conceivably think that the child selected as your personal representative is somehow favored, and this can cause all kinds of family strife and hard feelings for years to come.

If you find that you're in a similar situation, you may be tempted to designate two or more of your children as co-personal representatives of your estate. Think carefully! You open up your estate to unnecessary disputes and complications if two or more people share that role and then start to use your estate as a battleground for disputes between themselves. As Abe Lincoln (or, for *Seinfeld* fans, George Costanza) may have put it, "A personal representative divided against itself cannot stand!"

A better alternative than co-personal representatives is to ask your attorney or perhaps your lifelong best friend (hopefully, a trustworthy one — remember the key characteristics!) to be your personal representative.

WARNING

If you own your own business, or are one of the handful of owners (along with several partners of a closely held business), you need to pay special attention to who you designate as your personal representative. Your personal representative may have to keep your business going. But if that person has no experience in your business, or doesn't have the time to devote to your business, a significant portion of your estate's value may go down the drain if your business collapses. Therefore, if you own a small business (see Chapters 15 and 16), you need to either select a personal representative who can represent your interests and keep your business going or make other business continuity arrangements separate from the usual personal representative responsibilities.

Paying your personal representative

Now that your personal representative has done all this work, what do they get? You really can't personally say, "Thanks for a job well done," because you're dead! Your personal representative is typically entitled to receive a personal representative fee. The fee varies among states, and the probate court approves the personal representative fee. Your personal representative receives payment at or near the end of the probate process.

Thinking Things through When Someone Asks You to Be a Personal Rep

What if your brother asks you to become his personal representative? Suddenly the tables are turned and you have to decide whether to take on that role. You now know what responsibilities are expected of you if you say yes.

But what factors do you consider in making your decision? If you accept the role as a personal representative, are you personally liable for anything to do with the estate? Well, the answer is no — most of the time. You aren't personally liable for any claims, lawsuits, or other monetary obligations of the estate itself as a personal representative.

TECHNICAL STUFF

Traditionally, a personal representative is held to a standard regarding investment responsibilities and liabilities known as the *prudent-person rule.* In many states, the prudent-person rule has been recently replaced by the similarly sounding — but functionally different — *prudent-investor rule.* The difference between the two relates to the personal representative's investment focus. The newer prudent-investor rule imposes significant new duties on the personal representative for how investments are managed, with resulting increases in potential liability if those duties aren't properly performed. Make sure you completely understand the specific rules and obligations that govern how you serve as a personal representative, if you find yourself in that role.

As a personal representative, you're entitled to receive a fee for your services. The fee is typically a percentage of the probate estate. Many times personal representatives waive their fee for a family member or good friend. Be aware that if you do accept the personal representative fee, the payment you receive is taxed as ordinary income. Compare tax rates between ordinary income and estate-related taxes to see if receiving payment or property is the most tax advantageous for you.

TIP

If you're also an heir or beneficiary of an estate for which you're serving as a personal representative, the distribution you receive is free of income tax (any applicable estate tax is usually taken before you get your share). If you're both a personal representative and beneficiary of the same estate, you should consider waiving the taxable personal representative fee in exchange for a tax-free larger distribution. If practical, you should also obtain consent of the other beneficiaries of the estate. (If, however, the estate has dozens or even hundreds of other beneficiaries, you likely won't be able to get everyone's consent, so just do your best to sidestep controversy.)

Despite the hassles and occasional aggravation, the vast majority of personal representatives find the job to be at least a little bit personally rewarding. You have a feeling of helping a friend or family member complete their final wishes and intentions. But again, as with anything in life, make sure you know what you're getting into before you agree to become someone's personal representative.

IN THIS CHAPTER

» Grasping the basics of will substitutes

» Looking at joint tenancy

» Utilizing living trusts

» Exploring additional types of will substitutes

Chapter 6

Dodging Probate: Saving Time and Money with a Will Substitute

In other chapters, we point you toward two main objectives of estate planning: protecting your property and controlling it as long as possible after you die. Your will is your number-one legal weapon, of course.

But you have other ways to reach your goals of maintaining protection and control — various types of contracts, agreements, and legal documents that are called *will substitutes.* We discuss will substitutes in this chapter.

Understanding Will Substitutes

For many people, having a substitute conjures up memories of school days. When you heard that a sub was coming in for the regular teacher, you wanted to know whether the stand-in was harder or easier than your regular teacher. (We all hoped the sub would show a movie. Any movie was better than drilling multiplication tables or conjugating verbs.)

As with substitute teachers, you're wise to be prepared and do your homework about various types of will substitutes and figure out which ones, if any, make sense for your estate planning. Some will substitutes (like some substitute teachers) can give you peace of mind by filling in the gaps and working hand-in-hand with what you've specified in your will. Other will substitutes (like the occasional nasty substitute teacher who for some reason seemed to pick on you) may actually have very little benefit for you, other than wasting some of your money and triggering unpleasant consequences down the road.

REMEMBER

In your will, you specify your instructions for what you want to happen to your property after you die. You can specifically mention various items and who will get those items, or you can use your will's residuary clause to instruct how anything you haven't specifically mentioned should be distributed and to whom. If you forget to include a residuary clause in your will, or if you die without a valid will, your state's intestate laws come into play and "write a will for you" that determines who gets what.

However, the covered-in-your-will-or-not distinction has a little wrinkle, and that's where will substitutes come in. Will substitutes treat property transfers by designating who receives the property at your death through *operation of law* or by *operation of contract.* The same way that certain *statutes* (see Chapter 4) can interpret and may override what your will says, will substitutes can take precedence over both your will and your state's intestate laws.

Why would you want to use a will substitute rather than your will for certain property? We have a one-word answer for you: probate! Actually, make that three words: outside of probate. Property covered by a will substitute is transferred outside of probate, which may provide you with some significant advantages in the following:

- **Time:** In Chapter 5, we discuss that the probate process can be lengthy (especially if you have a complicated estate) and the actual transfer of property typically doesn't occur until probate is mostly or totally completed. With will substitutes, however, property is typically transferred immediately upon your death, even if other parts of your estate are just beginning what may be a lengthy probate process.
- **Money:** Will substitutes may save you and your estate some money, depending on whether your state's version of the Estate Recovery Act applies to your estate *after* you die (The act does *not* take your property while you're still alive — whew!) We discuss the Estate Recovery Act, used to recover certain government-provided health-care expenses you may receive, in Chapter 10. For purposes of discussing will substitutes, remember that your state's version of the Estate Recovery Act may apply only to your probate estate. In Chapter 5, we note that by definition, your probate estate only includes your

property that is passing through probate, and certain property — including what is covered by various forms of will substitutes — isn't part of your probate estate. Therefore, if the government is trying to grab part of your estate after you die under provisions of its Estate Recovery Act, you may be able to protect property from the government's grasp by using will substitutes rather than allowing your will to control that property via probate.

WARNING

If the resulting transfer of non-probate property results in a death tax — whether state, federal, or any other tax — the taxes must still be paid. Will substitutes only help you do an end run around probate; applicable death taxes must still be paid. However, in many cases, will substitutes may reduce your taxes, so work with your estate-planning team to coordinate your tax strategy with what you plan to do for will substitutes.

Sorting through the List of Will Substitutes

You can hold property in a variety of will substitute types, including joint tenancy and living trusts. We discuss each of these types of will substitutes in detail in the following sections. Additionally, try to have at least a passing familiarity with some other will substitutes, including:

- Tenancy by the entirety
- Payable on death accounts (PODs)
- Individual retirement accounts (IRAs), life insurance annuities, and other assets paid to named beneficiaries

Will substitutes predetermine who gets your property upon your death by one of two ways:

- Right of survivorship
- Beneficiary designation

Joint tenancy, tenancy by the entirety, and PODs use right of survivorship, while the other will substitute types use beneficiary designations.

Figuring out joint tenancy

Joint tenancy means that you and others have an equal and undivided ownership of some property. Basically, each joint tenant has the same right to use whatever property the joint tenancy agreement applies to. Joint tenants must own an equal percentage of the property. If two people hold interest in property as joint tenants, each typically owns one-half of the property; if three people hold interest, then each typically owns one-third; four people, each typically owns one-fourth; and so on. (However, the typical 50/50 split or any other equal division of interest could be overridden by some sort of agreement among the joint tenants or on the ownership instrument itself.)

The distinguishing characteristic of joint tenancy as a will substitute is the *right of survivorship.* In fact, joint tenancy is usually referred to as *joint tenancy with right of survivorship,* sometimes abbreviated JTWROS. The key feature of joint tenancy is that when you die, the other co-owner(s) receive your share of the property by *right of survivorship.* Whether you have a will or not is immaterial to the property transfer. If you have a will, the property transfers outside of your will. If you don't have a will, the property transfers outside of intestate succession laws. The surviving joint tenant(s) receive the property. Although this is very serious business, you may want to think of survivorship as the "last person standing" in a game; whoever is left takes what's left!

TECHNICAL STUFF

Note, however, that if the account is designated as a tenancy in common, the deceased owner's share will pass through their will and not necessarily to the surviving joint owner.

WARNING

Family members often create joint tenancy to automatically leave property to the surviving joint tenant family member. However, as we discuss later, joint tenancy has some significant disadvantages, so work with your attorney to figure out whether joint tenancy, or perhaps some other form of a will substitute (such as living trust), best suits your needs.

For example, Tom and Meghan own a house, and they hold title to the property as joint tenants with right of survivorship. Upon Tom's death, Meghan automatically receives Tom's share of the house because of the right of survivorship feature as joint tenants.

Now, suppose Tom, Meghan, and Avery — three people now instead of two — own the house as joint tenants with right of survivorship, meaning that each of them owns one-third of the house. Again, Tom dies. In this case, Tom's share of the house is split equally between Meghan and Avery, each of whom now has a one-half interest in the house as joint tenants with right of survivorship. Later, upon one of their deaths, the surviving joint tenant will own the house.

TECHNICAL STUFF

In most states, during their lifetime a joint tenant can sever the joint tenancy without the consent or notification to the other joint tenants. The joint tenant who severs the joint tenancy then owns the property as a tenant in common with the other former joint tenant. But if more than one joint tenant remains, they still own their share of the property as joint tenants between themselves.

What? An example clarifies the preceding confusing scenario. Suppose Tom, Meghan, and Avery still own the house as joint tenants from the previous example. But Tom decides to *deed* (basically, to give) his interest to Sandra, thereby breaking his joint tenancy with the other co-owners. Now, the property is owned as follows: Sandra owns a one-third interest as a tenant in common and Meghan and Avery own two-thirds interest as joint tenants between themselves.

Remember: Meghan and Avery still own the property as joint tenants so they have retained the right of survivorship with each other for their portion of the property. If Avery dies, Meghan receives Avery's share of the property by right of survivorship and would then own two-thirds of the property as a tenant in common with Sandra.

Later, if Sandra dies before Meghan, her share of the property goes to her heirs or beneficiaries and not to Meghan as the other co-owner because at that point, Sandra and Meghan own the property together as tenants in common. No right of survivorship feature exists because long ago, Tom (the original one-third owner who had deeded his interest to Sandra) broke his side of the joint tenancy relationship. Likewise, because Meghan no longer has a co-joint-tenant, her interest also passes to her heirs or beneficiaries at her death and not automatically to Sandra.

DON'T CONFUSE ME!

A sort-of-related form of ownership to joint tenancy that isn't a will substitute form is *tenants in common.* With tenants in common, equal ownership of the property isn't required as it is with joint tenancy. Additionally, no right of survivorship feature exists so ownership interests can be given to anyone. However, many people confuse these two types of ownership because both use derivatives of the word *tenant* (*tenancy* in one form, *tenants* in the other).

Also, don't let the word *tenant* or the phrase *joint tenancy* confuse you. Joint tenancy (or, for that matter, tenants in common) doesn't mean that you and others are renting (and are tenants of) some particular property like an apartment or a townhouse. At the risk of getting too legally technical, a tenancy is a right to "own" property for a specific period of time. In this case, the period of time is measured by the life of the other tenant(s) rather than six months, or one year, or some other finite unit of calendar time set out in a lease or rental agreement, as you may have for an apartment or house.

Advantages of joint tenancy

Why should you consider joint tenancy specifically as a will substitute? As an alternative to probate, joint tenancy provides you with several advantages:

- **Cost savings:** The formation and eventual termination of joint tenancy is inexpensive. Unlike other forms of will substitutes, such as a living trust that an attorney should at least review and ideally prepare, you may save money by not necessarily needing to use an attorney to create a joint tenancy. (However, as with all other aspects of your estate planning, we strongly recommend that you work with your attorney as you plan your strategy and figure out what techniques best apply to you.)
- **Clear title transfer:** Because joint tenancy is based on right of survivorship, joint tenancy allows for a clear transfer of title to the surviving joint tenant. No questions exist about the intent of who is to receive the property upon the death of one of the joint tenants. (To be certain that no question about intent exists, some states require that the wording *as tenants with rights of survivorship and not as tenants in common* be added.)
- **Reductions in creditors' claims:** One of the main steps in the probate process is the payment of valid creditors' claims. Before any of your beneficiaries can receive property transfers after you die, your personal representative must first pay any valid creditors' claims. If your estate doesn't have enough cash or cash equivalents to satisfy the creditors' claims, your estate may be forced to sell property to pay the claims. However, because property held as joint tenants isn't part of the probate process, creditors will need to pursue their claims outside of the probate process, such as action against the subject property after it passes to the surviving joint tenant.

  WARNING

  If the court can prove that you transferred title of property to joint tenants to hide from creditors, your creditors may still make a claim against part of your joint tenancy property.
- **Convenience and speed:** You can easily create and ultimately dissolve ownership as you craft and later refine your estate plan. Furthermore, by not having to deal with complex legal documents — wills, trusts, and living trusts — you can use joint tenancy without worrying about the legality and hassles of the wording in these documents. Just a few simple words added to the property title, and you're done. In estate planning, you can't get any faster than that! Beware, though: Even though you can dissolve the joint tenancy after it's created, you can't turn back the clock to the way things were before you created the joint tenancy without the permission of the other joint tenant(s).

» **Privacy:** If you value your privacy, even after you've died, joint tenancy offers you a better alternative than probate, where your will and estate become part of the public record. Note, however, that if your state has an inheritance or estate tax you may be required to file a tax return and pay a tax on the decedent's share of the jointly owned property. Because the tax return is usually a matter of public record, your wishes for privacy will be defeated.

WARNING

Work out the tax scenarios with your accountant as part of your overall estate planning before you put joint tenancy wording on any property titles!

Disadvantages of joint tenancy

So far, so good with joint tenancy. The concept seems straightforward and the advantages sound pretty good. So, why hold property any other way? Well, you know the old saying: If it sounds too good to be true, it must be an estate-planning concept! Holding property as joint tenants also has significant limitations and disadvantages that you need to be aware of. In fact, you'll find professionals in the estate-planning arena who strongly advise *against* holding property as joint tenants with right of survivorship.

The limitations and disadvantages include the following:

» **Forced disposition:** The surviving joint tenant(s) receive your share of the property. Period! You can't decide to leave a portion of that property to your joint tenant and another portion to someone else; the law forces you to leave your share to your joint tenant. So, depending on the property in question and what you want done with that property after you die, joint tenancy may not be the right estate-planning tactic.

» **Lack of control in property transfer:** The right of survivorship feature may not control the final transfer of property under joint tenancy. The death of the next-to-last joint tenant leaves the property to the surviving joint tenant as sole property; no right of survivorship exists when you own something by yourself. So, unless other arrangements are made (even creating a brand-new joint tenancy with other people), the property may ultimately become a part of the sole surviving joint tenant's estate.

» **Undesirable property transfers:** After the next-to-last joint tenant has died, the surviving joint tenant can dispose of the property in any way they want, even if the disposal is contrary to the intentions of any other joint tenants who have died earlier. In effect, if you're involved in a joint tenancy, you have to let go of any desires you have for the ultimate disposal of the property beyond the other joint tenants.

For example, suppose Kathy and Greg, who aren't married and have no children, own a house as joint tenants. They discuss their intentions to leave the house upon their deaths to their favorite local charity. But after Kathy dies, Greg owns the house as the surviving joint tenant and can direct the property transfer to anyone he chooses at his death. Suppose Greg changes his mind and decides that instead of the charity, his sister — who didn't get along with Kathy — gets the house at his death. So, Greg's sister receives the house, and Kathy's intentions for the property are out the window.

If the property had been named in a will or held in a trust, they may have set up a chain of property transfers. The will could state that the survivor had use of the house while they were alive and upon their death, the charity would be guaranteed to receive the house. In effect, choosing joint tenancy prevented Kathy from achieving her ultimate objective for the property.

- **Unintentional property transfers:** Suppose a married couple has children, but then one of them passes away. Later, the surviving spouse remarries. The new spouse would be the joint tenant with right of survivorship, and that new spouse could leave the property to only their children and not the deceased spouse's children. This could be completely unintentional, but it does happen, and it's a potential consequence of holding property as joint tenants with right of survivorship.
- **Probate postponed:** Property held as joint tenants with right of survivorship still goes through probate after the last joint tenant dies, and the property must go through probate if all joint tenants perish together.
- **Incapacity:** If either of the joint tenants becomes incapacitated, the other joint tenant may have to petition the court before they can further dispose of the property held as joint tenants with right of survivorship.
- **Exposure to the other joint tenant's creditors:** We mention that joint tenancy may protect property from your creditors' claims after you die, but what about protection from creditors' claims against your joint tenant? For example, if your joint tenant loses a court battle and has a large judgment against them, the property you hold as joint tenants can potentially be subject to the judgment, resulting in a forced sale of the property.
- **Numerous tax disadvantages:** Perhaps the biggest disadvantage of joint tenancy is in the area of taxes. A tax disadvantage? Didn't we say earlier that a potential income tax savings from joint tenancy by the surviving joint tenant in a lower tax bracket may occur? Well, yes. But taxes are funny: In estate planning, what often saves you money in one tax area increases your taxes (sometimes significantly) in another tax area. In this case, the savings in income tax may be more than offset by the increase in estate tax.

JOINT TENANCY AND UNMARRIED COUPLES

Many unmarried couples (either same sex or opposite sex) use joint tenancy with right of survivorship as a way to transfer their respective ownership shares to their partner. As we discuss in Chapter 19, most estate-planning laws are oriented toward "traditional" families (a married couple, 2.5 children, and so on). If you're in an unmarried relationship and you co-own your home with your partner, joint tenancy with right of survivorship may be an ideal way to protect your partner's right to stay in the home after you die (and vice versa), even though the law doesn't recognize your relationship in the same way as — and with the same rights of — a married couple.

TECHNICAL STUFF

For example, if you're the surviving joint tenant from a property that you once held with two others as joint tenants, this property may inadvertently cause a payment of a larger estate tax. In Chapter 10, we discuss how property held as joint tenants between spouses only receives one-half of the *stepped-up tax basis,* which is a way of resetting some of the figures that are used to calculate the amount of taxes you owe. Furthermore, if your estate is large enough to be in a federal estate tax bracket, joint ownership and particularly a joint tenancy (or a tenancy by the entirety between husband and wife, as we discuss later in this chapter) may preclude the ability to save or reduce federal estate taxes. For now, think of joint tenancy as having potential tax disadvantages when compared with wills or other will substitutes such as living trusts.

Setting up a living trust

We examine trusts in-depth in Chapters 7, 8, and 9, but here, we introduce the living trust due to its popularity as a will substitute form. A *living trust* is created while you're alive (thus, the use of the word *living*), unlike a *testamentary trust*, which is created at your death through your will. (Technically, a testamentary trust is similar to a will because it provides for property transfers at your death.)

You place certain property called *trust principal* into a living trust. (You may also see the word *corpus* referring to the property used to fund the trust, which often makes people nervous, considering how similar that word sounds to *corpse* — makes sense because both *corpus* and *corpse* come from the same Latin root meaning "body.")

When you create a revocable living trust, you can be in charge of your own living trust. When you die, the revocable living trust becomes *irrevocable* (meaning you can't "undo" the trust — we discuss irrevocable trusts in Chapter 7) — and the trust principal (again, the property that you've placed into the trust) then passes to your beneficiaries without having to go through probate.

By making a trust revocable, you can dissolve the trust at any time up until death or until the trust document makes the trust irrevocable (such as in the event of your incapacity).

REMEMBER

At this point, however, you'll want to understand the rules of your particular state to determine if your state inheritance tax is different from the federal tax and determine if there are any particular tax advantages to setting up your living trust.

Roles for everyone!

TECHNICAL STUFF

The best way to examine a living trust is to look at the parties and roles involved. Living trusts involve the following roles (note that one person can play more than one role, as we explain later in this chapter):

- Trustor (or settlor)
- Trustee
- Successor trustee
- Income beneficiaries (or current beneficiaries)
- Remainderman (a "special class" of beneficiary)
- Designated person managing minor beneficiaries

Don't panic at the legal jargon! In a typical trust, the *trustor* (or *settlor*) creates the trust, and the *trustee* has the legal interest in managing the trust for the *income beneficiaries* who will have beneficial interest or right to use the trust property. After the beneficiaries receive their portion of trust, the *remainderman* is the trust beneficiary who receives the *remainder* (what's left over).

In Chapter 1, we discuss two main types of property interest: legal (the right to manage property) and beneficial (the right to benefit from the property). Trustees have the legal interest to transfer and manage property in the trust; beneficiaries have the right to use the property.

The *successor trustee* is the person you name to become trustee when you die (or become incapacitated) if you're currently the named trustee. Think of your successor trustee as the personal representative of your trust. Look for a successor trustee who has the same attributes we recommend for a personal representative in Chapter 5. Typically, people name a spouse, child, or trusted friends as successor trustees.

You need to appoint someone (usually referred to as a guardian or a custodian) to manage the property of *minor beneficiaries* — those beneficiaries who aren't of legal age.

The paperwork — ugh!

The actual living trust document varies just as wills do. (We strongly recommend working with your attorney to make sure you get all the necessary information correctly on paper.) The variations may include

- Designating the trustor and the initial trustee
- Defining trust property
- Naming a successor trustee
- Defining ways to revoke or amend the trust
- Administering trust by trustee during the trustor's lifetime
- Administering trust by the successor trustee after the trustor's death or incapacity
- Defining the trustee's power
- Restricting beneficiary assignments (with something called the *spendthrift clause*)

You can find more details about the paperwork associated with trusts in Chapters 7, 8, and 9. The trust sets forth in detail how the trustor must handle the trust after you've died.

Advantages of living trusts

So, why the frenzy over living trusts? Living trusts are a convenient way to avoid additional probates if you have real property like a house, vacation home, or income-producing investment property located in more than one state.

Real property must be probated in the state where the property is located (we discuss *ancillary probates,* or additional probates, in Chapter 4). More than likely, your entire probate process will be slowed down because of the need to administer more than one probate and the increases in fees and costs.

TIP

Some states consider real property held in a living trust to be intangible personal property enabling your estate to avoid ancillary probate. If you have real property in more than one state, check to see how your state views real property held in a trust.

Privacy (as compared with probate) is another advantage of a living trust. As with other will substitute forms, your trust is a private agreement — a contract between the trustee and trustor. However, some county recorder offices require the filing of trusts as part of the public record.

To retain the privacy of trusts, your attorney can draft a separate document called a *memorandum of trust*, which identifies the most basic information of the trust. Therefore, your trust usually doesn't become public record as your will does in probate.

WARNING

However, if your state has an inheritance tax, the trust's details may be required to be filed with the state through an inheritance tax return or other document. You may need to include the amount of trust principal and the identification of beneficiaries or the remainderman.

The real attraction of living trusts stems from the advantages offered beyond the typical will substitute form advantages. Living trusts offer unique advantages:

- Better planning
- Better protection from probate
- Better prediction of the future
- Ability to name alternate beneficiaries
- Ability to name guardianships

In preparing a trust, you place property into the trust (called *funding the trust*), and that property is thereafter known as your *trust principal.* By thinking through what property to include in your trust principal, you examine what property you have.

REMEMBER

Unlike joint tenancy, where ultimately the last surviving joint tenant holds the property that can become part of the probate estate, living trusts provide you with better assurance of avoiding probate. In our earlier example, if Tom and Meghan own a house as joint tenants and Tom dies, Meghan, as the surviving joint tenant, now owns the house individually, making the house part of her probate property.

But instead of joint tenancy, suppose Tom and Meghan use a living trust to hold title as co-trustors and co-trustees to the house for both of their lifetimes. If Tom dies, Meghan still owns the house in trust, and the house is not part of the probate estate. Upon Meghan's death, the house passes from the trust to the designated beneficiaries without being subjected to probate.

And what does predicting the future have to do with living trusts? Plenty, sort of. A living trust provides you with a peek into your estate's future and how it will be handled. If you establish a trust as the trustor and name someone other than yourself as the trustee to manage your trust, you can preview how they handle the management of the trust property and determine if adjustments in your estate need to be made. No need for guesswork on how they'll perform when you're dead, when you can't make any changes (for obvious reasons). You can preview the future now.

If your trust is set up to make distributions while you're alive, you have the opportunity to see how both your trustee and beneficiaries may handle the trust principal distributions affording you the opportunity to make adjustments, if needed.

A living trust also allows you to name alternate beneficiaries if something happens to your primary beneficiary. You can't name an alternate with other will substitute forms like joint tenancy or, as we discuss later, payable on death accounts.

And if you're incapacitated and not able to care for your own affairs, you can set up a living trust to provide for you. This advantage is part of the reason living trusts are touted for the elderly. In such a case, you can avoid the necessity of a court-appointed guardian or conservator, or at least assist those persons in carrying out their duties.

TECHNICAL STUFF

Another method of avoiding guardianship or conservatorship is by the popular *durable power of attorney* (see Chapter 19), usually in addition to a living will.

Disadvantages of living trusts

Keep this adage in mind when you're planning your estate: No good will substitute goes unpunished! Disadvantages exist no matter what road you choose, even with living trusts. These disadvantages include

- Funding
- Ongoing maintenance
- A longer creditor claims period

The up-front funding of the living trust is a deterrent to many people. ***Remember:*** To hold title as joint tenancy, all you have to do is change the title to the property with the appropriate wording. It's not so simple with living trusts.

Living trusts require you to execute a trust document. But beyond the paperwork, the next step in the process is the trust's actual funding. You as trustor must transfer your property's title to the trust. So, what's the problem? Every time you acquire property — from stocks to real estate — you must transfer title of the property into the trust. For active investors, transferring your property's title to the trust can become a hassle. (Then think about other property — such as cars, furniture, collectibles, and so on — which can be even more of a hassle!)

WARNING

If you forget to put property in your trust, the property is treated as if it was never part of the trust and is handled through probate if you have a will or intestate succession laws if you don't have a will. For example, if you're the beneficiary of someone's life insurance or if you receive property that was formerly held as part of a joint tenancy — and you forget to take care of this property for living trust purposes — then that property isn't part of the living trust.

Trusts require monitoring to make sure that everything is proceeding in accordance with the terms of the trust. Don't just sign a trust document and put it away. The only way to achieve the advantage of previewing the future is to monitor the trust on an ongoing basis, which takes time and may not be for everyone.

Another living trust disadvantage is the potentially longer period for creditors' claims. Why? In some states, trusts don't protect property from being subject to creditors' claims. Consequently, trustees may delay distributions to beneficiaries and the remainderman until they're certain all claims have been paid. ***Remember:*** No probate for trust principal exists so consequently no probate process exists for the controlled processing of creditors' claims.

WARNING

If a trustee doesn't perform certain required duties after the trustor's death, they can have substantial personal liability. This reason is why trustees often delay property transfers until they're certain all creditors have been paid.

Focusing on the costs of living trusts

You may have noticed that we didn't mention the costs of living trusts as either an advantage or disadvantage. Why? Because the costs to set up a living trust can vary greatly. As with your will, you can prepare a basic living trust with preprinted legal forms or alternatively, with an attorney.

Accordingly, the costs can range from a few dollars if you go the do-it-yourself route to more than several thousand dollars for each living trust that an attorney prepares. Because a living trust is considered a contract between the trustor and trustee, we strongly suggest that you don't mess around with a contract that may contain glitches. A living trust requires careful preparation and thinking. So, just as with your will, if you decide to try to create a living trust on your own (which, again, we don't recommend), at least have an attorney review it before execution.

Interestingly, the promotion and marketing of living trusts as part of estate planning has been anything but subtle. Some financial advisers hype living trusts, especially to older people — giving sales pitches on how living trusts are the solution to all the world's ills, and bombard them with offers of expensive how-to seminars, workshops, and books on living trusts. Before exploring any of these options, make sure you understand what's being offered and what it will cost you. Although these preparations are touted as cost saving, you'll probably find it less expensive to work one-on-one with an attorney on your living trust instead of buying an expensive, boilerplate sales pitch.

Identifying Some Less Common but Worthy Will Substitutes

Beyond joint tenancy and revocable living trusts, you have some other options for will substitutes available. Although not as common as the first two methods, the ones we discuss still provide you with the opportunity to use will substitutes in your estate planning.

Tenancy by the entirety: The spouse's option

Tenancy by the entirety — also called *interests by the entirety* — is related to joint tenancy. Similar to joint tenancy, the property's co-owners have a right of survivorship feature that enables property to automatically transfer at the death of a co-owner to the surviving co-owner. Different states have different rules for tenancy by the entirety, so make sure your attorney advises you as you consider this type of will substitute.

The distinguishing characteristic of this form of will substitute: Only spouses can use it. Unlike joint tenancy, which can have any number of unrelated parties, a husband and wife are the only people eligible to hold property as tenancy by the entirety. The surviving spouse becomes the sole property owner.

Tenancy by the entirety follows general guidelines for marital life. Always tell your spouse what you're doing! Accordingly, one spouse can't transfer their interest in the property without the consent of or notification to the other spouse. (***Remember:*** A joint tenant can transfer their share to another person without the consent or notification of the other joint tenants.)

WARNING

Many states don't allow property to be held as tenancy by the entirety. Specifically, tenancy by the entirety isn't recognized in most community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin), and even some common law states don't allow it. Where tenancy by the entirety is available, a divorce changes property ownership from tenancy by the entirety to tenants in common. Take note, though: If you decide to explore using this will substitute form, check with an attorney to see if your state recognizes it.

Joint tenancy bank accounts

A joint tenancy bank account is a form of joint tenancy where two or more people take title to property — in this case a bank account — with the surviving joint tenant receiving the proceeds from the account.

With joint tenancy, a joint tenant can sever the joint tenancy without the consent or notification to the other joint tenants. Here, the bank account joint tenant can sever the relationship by withdrawing funds from the joint account.

WARNING

Gift taxes (see Chapter 11 where we discuss how you're taxed on certain types of gifts you give, and how those gift taxes affect your estate planning) may come into play with joint tenancy bank accounts. Before you use this will substitute form, talk to your accountant and attorney to understand the implications. Don't just ask the person at the bank who helps you fill out the forms!

Savings bonds

Yes, the same savings bonds that along with green stamps, Hula-Hoops, and *Leave It to Beaver* are often thought of as icons of days long gone. But savings bonds actually are a form of will substitute.

Savings bonds can be issued in two ways:

- **Alternative payee:** When you use the *alternative payee* option on a savings bond, payment of the bond can go to either of the co-owners of the bond (you or your alternative) similar to the joint tenancy provision of right of survivorship. After one of you dies, the surviving payee is the bond's sole owner.
- **Beneficiary payee:** When you use the *beneficiary payee* option, you and another person have a similar relationship to a beneficiary named in your will. If the savings bond is yours, the beneficiary you've named receives the bond's proceeds after your death.

TIP

If you have a stash of savings bonds locked away in your safe-deposit box or some other safekeeping place, double-check to see what the estate-planning impact is of each individual bond when you're inventorying the contents of and determining your estate's value (see Chapter 2).

Payable on death accounts

We know they sound rather morbid, but *payable on death accounts* (PODs) are a simple will substitute form that keeps personal property out of probate. You fill out a form at your financial institutions and designate your account beneficiary. After your death, your beneficiary provides the financial institution with a copy of the death certificate and proof of identity and then collects what's in the account. Doesn't get much simpler than that.

TIP

Because your beneficiary receives the account proceeds at your death, you should periodically review the accounts for two reasons:

- **To verify that the named beneficiary is still who you want to receive the proceeds:** Remember you can change your mind at any time while you're alive.
- **To maintain the proper balance:** You want to make sure that the beneficiary of this account is receiving what you intended, rather than a distorted proportion because the value of the account has grown or diminished over time.

You should note that your beneficiary doesn't have beneficial interest in the account and, thus, can't withdraw money from the account until your death. You control your own bank account during your lifetime, and you have the flexibility to change your mind and name a different beneficiary, or you can even decide that you want to use the funds in the account. Easy come, easy go!

Deeds

For real property like your house, a deed is a weapon in your will substitutes arsenal available for your use.

TECHNICAL STUFF

A *deed* is the legal evidence of real estate ownership. Deeds, like wills, have several legal requirements in order to be valid, including being in writing with an accurate legal description of the property.

A TIP ABOUT ESTATE-PLANNING LEGAL-SPEAK

You may have noticed a pattern in legal terminology. Words ending in *–or* (like *trustor* and *grantor*) are always the person in control of the property. Conversely, words ending in *–ee* (like *trustee* or *grantee*) are always the person receiving something from the *–or*. An easy way to remember this is that *–ee* receives something from the *–or*. Put it together as *ee-or,* and you have Winnie-the-Pooh's buddy!

You can write wording into a deed to create a will substitute for your real property. Work with your attorney to make sure the wording in your deed accurately reflects the type of will substitute you want to set up. However, some states don't allow real estate to be transferred with a "transfer on death" deed so be sure to ask your professional!

WARNING

If the deed is used only as a property transfer mechanism at the grantor's death, the deed may not be considered a valid will substitute form and is subject to probate. Check with your attorney about state laws to find out what requirements are needed for a deed to be considered a will substitute form.

IRAs and your other retirement accounts

Even if you're just beginning your estate-planning efforts, you may already have will substitutes as part of your estate and not even know it!

Most of your retirement savings accounts — your traditional IRA, Roth IRA, 401(k), 403(b), and other retirement-oriented investments we discuss in Chapter 18 — are forms of will substitutes. See Chapter 18 for details on these accounts, what a beneficiary is, how you designate a beneficiary, and the tax implications. Naming beneficiaries on retirement and bank accounts continues to be a very popular way to avoid probate!

3 Matters of Trust

IN THIS PART . . .

Trust trusts for your estate plan.

Explore different types of trusts.

Match up your estate plan with your trust options.

IN THIS CHAPTER

» Defining trusts

» Looking at how trusts can enhance your estate planning

» Examining major categories of trusts

Chapter 7
Understanding Trusts

Hurry, hurry, step right up! Come see, with your very own eyes, the eighth wonder of the world: the trust! You can use a trust to save on estate taxes, to protect property in your estate, and to avoid probate! You can even use a trust to get dents out of your car and clean the toughest stains in your carpet!

Okay, we went a bit overboard on the last two items, but various types of trusts may be the secret weapons in your estate planning. Beware, though: Trusts are also the most overhyped part of estate planning, as well.

In this chapter, we help you make sense of the extremely complicated topic of trusts: what trusts are and why you may want to consider them for your estate plan. Before you seriously start considering trusts, you must understand the basics that we discuss in this chapter so you can make informed decisions about what does — and doesn't — make sense for you.

Defining Trusts, Avoiding Hype

WARNING

Trusts can be difficult to understand when you hear some estate-planning professionals talk about them. But those people may be more interested in selling you expensive investment vehicles than making sure you understand enough about trusts to make wise and informed decisions yourself.

Don't worry. In this section, we help you get a handle on trusts — with three definitions:

- An incredibly oversimplified definition
- A slightly more complicated definition, but still using plain language
- An "official" definition that uses just enough legalese, but still won't cause your head to start spinning

Shazam! An oversimplified definition of trusts

In many comic books and related movies and TV shows, an ordinary person goes into a "special place" and comes out a superhero with a new identity and, very often, superpowers. Bruce Wayne goes into the Batcave and comes out Batman. Clark Kent goes into a phone booth and comes out Superman. Billy Batson says "Shazam!" and turns into Captain Marvel.

Think of a trust as a special place in which ordinary property from your estate goes in and, as the result of some type of transformation that occurs, takes on a sort of new identity and often is bestowed with superpowers: immunity from estate taxes, resistance to probate, and so on.

So, in many ways, a trust is your own personal Batcave — a place to go where you want to change the identity of some of your estate's property. And even though Batman doesn't have any superpowers, he does pick up that nifty utility belt with all kinds of weapons while he's in the Batcave. So, although property is in your trust, it can "pick up its own utility belt" and do things that aren't possible outside the trust.

Adding a bit of complexity with an ingredient list

Suppose you want to set up a trust. Just as with following a recipe or building something in your garage workshop, make sure you have everything you need before you start. To cook up a trust, you need these seven basic ingredients:

- The person setting up the trust (that's you)
- The reason you want to set up the trust and certain objectives you want to achieve
- The trust document itself

- The property that you decide you're going to place into the trust
- The trust's beneficiary (or beneficiaries, if more than one), whether that beneficiary is a person (your oldest daughter, for example) or an institution (such as a charity)
- Someone to watch over and manage the trust and the property that is now in the trust
- A set of rules that tells the person watching over and managing the trust what they can and can't do

All the items in the preceding list come together, and when everything is done properly — presto! — you now have a trust!

Adding some lawyer talk to the definition

If you're comfortable with a little bit of legalese — just a little bit, we promise — read on for a somewhat more "official" manner than comic book analogies and simple recipe-style lists. Adding some attorney talk to the seven basic elements, here goes:

- **Person setting up the trust:** This person is commonly known as the *trustor,* though you may sometimes see the terms *settlor* or *grantor.*
- **Objective of the trust:** You use different types of trusts to achieve a variety of specific estate-planning objectives. You can use some trusts for a single estate-planning objective, while others help you achieve more than one goal. Some of the most common estate-planning objectives for trusts are to reduce the amount of estate tax liability, to protect property in your estate, and to avoid probate for certain property. Before you decide whether you need one type of trust or another, you must think about what you're trying to accomplish in the first place!
- **Specific kind of trust:** As we discuss in the "Trust Power: Making Your Beneficiaries Smile" section later in this chapter and in Chapter 8, trusts come in many different varieties. And just like ice cream, yogurt, or pudding, you find different colors and flavors, some of which you may like and others of which just don't do it for you. Regardless, when you're setting up a trust, you need to decide what type of trust you want and make sure to follow all the rules for that particular type of trust to make sure that it's proper and legal and carries out your intentions.
- **Property:** After you place property into a trust, that property is formally known as *trust property* — or corpus. Reminds you of corpse, doesn't it? That's because the term *corpus* originates from Latin and means "body." However, in the context of trusts, it means "body of property" in the trust. So, just like with our Batcave analogy, the property now has a different identity and, in one way

or another, isn't quite the same as it was before you placed it into trust, even though underneath the Batman costume, the body is still the same.

- **Beneficiary:** Just as with other aspects of your estate plan (your will, for example), a trust's *beneficiary* (or, if more than one, *beneficiaries*) benefits from the trust in some way, usually because the person or institution will eventually receive some or all of the property that was placed into trust.
- **Trustee:** The person in charge of the trust is known as the *trustee.* The trustee needs to clearly understand the rules for the type of trust they're managing to make sure everything in the trust stays in working order.
- **Rules:** Finally, some of the rules that must be followed are inherently part of the type of trust used, while other rules depend on what's specified in the *trust agreement.* You'll find still more rules in state and federal law.

REMEMBER

Putting all the preceding information together, the trust agreement is a document that spells out the rules that you — the *trustor* — want followed for the property that you've placed into the trust to benefit the beneficiary (or beneficiaries) of the trust, as managed by the trustee. (Got all that? If not, reread that sentence until it makes sense, checking back with the previous list to help clear up the parts that seem difficult.)

Consider the following simple example: You decide to put $300,000 in a trust for your twin 10-year-old daughters, and you want your sister to oversee the trust. You specify that neither daughter is allowed to receive anything other than interest on the property in that trust before reaching the age of 25 and then can only receive a maximum of $10,000 each year on her birthday until the age of 35, at which time the remaining money in the trust (which hopefully has been growing along the way because of your sister's wise investment choices) will be split 50/50 between the two of them. It's worth noting that instead of limiting the amount each daughter can receive until reaching a certain age, you can also make rules that govern how the money from the trust can be used. For example, you may want to prevent your daughters from foolishly spending their $10,000 on fun and games so you can specify that the money may only be used for educational expenses or medical care.

In this example, you're the trustor, your twin daughters are the beneficiaries, and your sister is the trustee. The conditions about when your daughters can start receiving money, how much, and until when are part of the *terms* of the trust agreement.

But what kind of trust can you set up? Aha! That is often the $64,000 question (or $300,000 question, or $1 million question or perhaps the $5,000 question . . . all depending on the value of the property you place in the trust). As we mention, you can use different trusts to achieve different objectives; in the "Trust Power:

Making Your Beneficiaries Smile" section, later in this chapter, we begin to discuss the major categories to lead into Chapter 8's discussion of different types of trusts.

Attaching all the bells and whistles to a trust

Beyond the basic definition (or, in our case, multiple definitions) of what a trust is, you need to be aware of several little tidbits about trusts. When Batman enters the Batcave, he needs to know where his utility belt is, if the Batmobile has enough fuel, and where he's headed as soon as he gets outside. Otherwise, he may be in big trouble.

The same is true for trusts, which is why you need to work with your estate-planning team — particularly your attorney — to make sure that before that trust goes into effect, you have everything in order and haven't set yourself up for the estate-planning equivalent of an ambush by the Joker.

TECHNICAL STUFF

The following list may seem a bit nitpicky, but you can use the items in this list when you work with your attorney to avoid any problems. For example,

- **Make sure the trust agreement is in writing.** An oral trust may be considered legally valid, just like an oral (nuncupative) will, as we discuss in Chapter 3. Certain trusts, such as those dealing with real estate, must be in writing. However, just as with your will, you should put the trust agreement in writing instead of relying on word of mouth so misunderstandings or other problems don't arise!
- **A trust must provide duties and obligations for the *trustee* (again, the person in charge of the trust).** Typical duties and obligations include how and when to make payments from the trust, or how to manage or oversee the property in the trust (such as paying property taxes on real estate in the trust, renewing certificates of deposit in the trust, and so on). In legalese, a trust that adequately features such duties and responsibilities is known as an *active trust.*

  WARNING

  If the trust doesn't adequately include trustee duties and obligations, a court may consider it to be a *passive trust.* Watch out! The court may deem it as "no trust at all." Furthermore, the law automatically transfers the trust's property to the beneficiary or beneficiaries, and everyone loses out on whatever the objective of the trust was, such as tax savings. So, make sure that when you (or, more accurately, your attorney) set up a trust, the trustee's role is well defined so you won't have any down-the-road problems.
- **The wording of the trust agreement must clearly specify that you're actually setting up a trust and indicate what property you're placing in the trust (or intend to place in the trust at some future date).**

- **The trust agreement must clearly identify the beneficiary or beneficiaries — the person or people by name and other identifying characteristics ("my daughter Elly May Clampett," for example) or an institution ("The Meow Cat Shelter of Tucson, Arizona").**
- **Don't take the process of deciding on and appointing a trustee lightly!** Make sure that whoever you select as a trustee has the right background — education or profession, for example — for the job at hand. If you want someone to manage a trust containing lots of money, make sure the trustee understands and has adequate experience in portfolio management, diversification strategies, and other investment management techniques.

  But just as important as (maybe even more important than) education and professional background is that your trustee has the honesty, character, and integrity to fulfill the responsibilities. Sometimes being in charge of lots of money intended for someone else (the trust's beneficiary or beneficiaries) can be, shall we say, a bit too tempting. The good news is that the legal system in most states provides for trust beneficiaries to be able to ask a court to enforce the terms of a trust so the trustee can't do things that aren't allowed or permitted by the trust (hence, by law). In some cases, state agencies may even be the ones who step in to ensure that a trust is used as it was originally intended. For example, a state welfare agency may be able to request that the court overrule certain spending decisions made by the trustee when the child beneficiary had educational or medical needs.

In Chapter 1, we discuss how a trustee may have a *legal interest* in the property in a trust but doesn't have a *beneficial interest.* The trustee is responsible for managing the trust's property, but they can't benefit from the trust other than receiving the agreed-to trustee compensation (fees and costs) for taking on this job.

Designate a *successor trustee* — a pinch hitter to step in if the primary trustee can't serve or continue to serve for some reason — when you set up a trust. Otherwise, the court that has jurisdiction may appoint a successor trustee, and that person may not be someone you want.

Trust Power: Making Your Beneficiaries Smile

You're probably thinking: "Why should I care about trusts?"

In a very general sense, the primary reason you set up a trust is to benefit a person or institution more than if you didn't set up the trust. After all, trusts are often complex, can be time consuming to set up and oversee, and cost you some amount of money (a modest amount for a straightforward trust, or perhaps a lot of money for a very complex setup involving multiple trusts, different jurisdictions' laws, and so on). So, you should have a good reason to go to all this trouble!

By benefiting a person or institution better, we mean examples like the following:

- **You have some part of your estate or your overall personal financial situation, such as a life insurance policy, that under applicable law is likely to cost your estate some amount of money in estate taxes.** But by setting up a trust, your estate can avoid paying some or all taxes, meaning that more money is left over for your trust's beneficiaries.
- **As we describe in Chapter 5, the probate process can cause problems for your estate, anywhere from minor annoyances and delays to major costs and inconvenience.** However, you can use trusts for certain property that you absolutely, positively don't want to be subjected to the problems and delays of probate. Your beneficiary may gain ownership and use of that property more quickly if you had set up a trust than if you used the regular method of having that property as part of your probate estate.

The following sections look at the most significant objectives you likely want to achieve by using trusts.

Avoiding taxes

Some trusts have the "special power" (or maybe that's "superpowers") to avoid estate-related taxes that otherwise may apply. One of the most common tax-saving trusts is an *irrevocable life insurance trust.* As we discuss in Chapter 17, after you die, the proceeds from your life insurance policy (the death benefit amount) are added back into your taxable estate, often turning an estate that isn't subject to federal estate taxes into an estate that needs to write a substantial check to the Internal Revenue Service!

However, an irrevocable life insurance trust is one of several ways you can shelter life insurance death benefit proceeds from estate taxes (see Chapter 8). After setting up the trust, there is still insurance on your life, and your beneficiary or beneficiaries still receive the proceeds from your policy upon your death. But now estate taxes may not be a problem.

Avoiding probate

In Chapter 6, we discuss *living trusts* as a form of will substitute to help you avoid probate.

By keeping certain property out of your *probate estate* (the part of your estate that is subject to probate; see Chapter 5), you may be able to avoid many of the hassles, costs, and lack of privacy concerns related to probate.

TIP

You have a number of other means at your disposal to avoid probate for other property — joint tenancy with right of survivorship, payable on death (POD) accounts, and others as we discuss in Chapter 6 — so work with your estate-planning team to figure out for each type of property in your estate what the best probate-avoidance tactic may be. For some, the costs of a trust may make sense, particularly if you're not only trying to avoid probate, but also trying to accomplish one of the other goals we discuss in this section (avoiding estate taxes, protecting your estate, and so on). For other property, a simpler, less costly way to avoid probate, such as joint tenancy, may be a better choice for you.

Protecting your estate (and your beneficiary's or beneficiaries' estate)

One of the primary uses of trusts is to protect your estate — not only while the estate is yours, but also when your estate becomes someone else's estate (and so on).

For example, suppose you want to leave $500,000 to your only son, but you're concerned that if you were to die while your son is still relatively young (say, under 30), he won't be responsible or mature enough to adequately manage a large amount of money. Before you can say, "sail around the world," you're afraid he will have spent the entire half-million.

You can use a trust in the manner that we describe in the example earlier in the chapter in "Adding some lawyer talk to the definition" to parcel out the money to your son as you see fit. The trust can give him a little bit each year for some duration, and then a final lump sum at some age when you think he'll be mature enough to protect the money as if he had actually earned it himself. Or you can add conditions to how the money in the trust is disbursed, such as your son receives a little bit of money until a certain age, and then he gets the rest only if he graduates college or meets some other criteria you determine when you set up the trust.

TIP

Trusts are an important part of your estate plan when you want to leave money to your minor children and make sure that

- The money is available to them when they reach certain ages.
- The money is set aside (think "officially reserved" meaning that nobody else can touch it) for your children and managed by a trustee, instead of just leaving it to your brother-in-law and saying, "Please don't spend this money on a Rolls-Royce; make sure you keep it safe for my kids." (Yeah, right!)

Providing funds for educational purposes

Another common use for trusts is to make money available to your children, grandchildren, other relatives, or even nonrelatives (your employees' children, for example) for educational purposes, such as college tuition and living expenses.

You can set up and fund trusts that parcel out money for educational purposes but that also come with the restriction of "no school, then no money!" In other words, you can specify that if the beneficiary is not earning a specific number of credits toward their degree each year, then the money stays right where it is — in the trust!

In Chapter 8, we look at various trusts particularly suited for educational purposes.

Benefiting charities and institutions

You can help out charities in many ways: gift giving (see Chapter 11) or by leaving money or other property to one or more institutions as part of your will (see Chapter 3).

Alternatively, you can set up some type of *charitable trust* (see Chapter 8) that may, for example, annually give money to the charity while you're still alive, give a larger amount upon your death, and then from what is left in the trust after you die continue to make regular payments to the charity. You can even set up a charitable trust to make regular payments to the charity for some amount of time but eventually "give back" whatever is left to you or, if you've died, to someone else in your family. Alternatively, you can set up a charitable trust to work the other way — pay you while you're still alive, and upon your death, the remaining amount in the trust goes to the charity.

Sorting Out Trusts — from Here to Eternity

In Chapter 8, we indoctrinate you into the complex world of trusts filled with alphabet-soup acronyms and a number of similar-sounding trust types. Before we do that, though, we need to fill you in on the different categories of trusts.

In general, you have two different ways of categorizing trusts:

- Trusts that are in effect while you're still alive versus those that take effect upon your death
- Trusts you can change your mind on versus those that are absolutely, positively, unchangeable

Trusts for when you're alive versus when you're gone

TECHNICAL STUFF

We're sorry about the legalese, but here goes: An *inter-vivos trust* is a trust that you set up and is in effect while you're still alive. In contrast, if you set up a trust under your will and that trust doesn't take effect until your death, you're using a *testamentary trust.* It isn't overly important to know exactly what these trusts are called by name, but it *is* very important to reach out to a competent legal professional who will know which trusts are right for your given set of circumstances.

Here's a quick example to emphasize the distinction between these two categories: Suppose you want to help out your favorite charity and, after consulting with your estate-planning team, you decide that a trust is the best way to go. If you set up a particular type of charitable trust (see Chapter 8) that makes annual payments to the charity while you're still alive, then that trust is an inter-vivos trust. If, however, you set up a trust under the terms of your will to become effective (and start making payments) after your death, you've set up a testamentary trust.

The following sections look at both of these categories of trust in more detail.

Selecting inter-vivos trusts for your estate plan

TIP

If your primary objective in creating a trust is to provide an economic benefit (cash payments, transfer of real property that is currently in your estate, and so on) to specific people or institutions (again, your children, your favorite niece or nephew, your favorite charity, and so forth) or for yourself, then you should strongly consider setting up some type of inter-vivos trust.

With an inter-vivos trust, payments and other types of property transfers may begin while you're still alive instead of waiting until you die (in this case, "sooner" is better than "later" when it comes to money). Furthermore, you usually have a better handle on the amount and value of your property with which you fund an inter-vivos trust than a testamentary trust, as we discuss in the next section.

With an inter-vivos trust, you know what your estate is worth and how much is available to fund such a trust. Essentially, you have a higher degree of control with an inter-vivos trust than with a testamentary trust, with certain limitations based upon other variations of trust, which we discuss in "Changing your mind: Revocable and irrevocable trusts." For example, if you transfer your home to an inter-vivos trust and you still reside in the home, you may inadvertently break a rule of a very specific type of trust. This is yet another reason why you and your lawyer need to thoroughly understand and plan your objectives and your estate plan carefully and completely.

When you set up an inter-vivos trust, you can initially fund the trust with certain property from your estate, add more property throughout your lifetime, and even make arrangements for additional property to be added to the trust upon your death. For example, if you initially fund an inter-vivos trust with stock, you can always add more later to cover any shortfalls if the shares you used for the trust have decreased in value. Or if your portfolio has skyrocketed — including the stock you used to fund the trust — and you're feeling particularly generous, you can increase the trust's value.

Choosing testamentary trusts for your estate plan

If you aren't particularly concerned about providing economic benefit to a trust beneficiary while you're still alive, you can still set up an inter-vivos trust, or you can hold off on creating the trust until after your death and instead, create a testamentary trust under your will.

So, how exactly do you set up a testamentary trust if you're already dead? Actually, you lay the groundwork for a testamentary trust in your will while you're still alive, which means the following:

- Along with all the other contents of your will that we discuss in Chapter 3 — specific giving clauses, the residuary clause, and so on — you include appropriate language to set up a testamentary trust that, just like everything else in your will, doesn't actually "come alive" until your death. (Ironic, huh?)
- Your will goes through probate and must be in compliance with various will statutes (see Chapter 4). Your testamentary trust also needs to be in

compliance because it's technically part of your will. If you make any goofs in the language you use relating to the trust(s) you want to establish, all kinds of complications set in, just as with any other part of your will.

TECHNICAL STUFF

- Unlike a testamentary trust, an inter-vivos trust generally doesn't have to go through probate, but the probate court still has jurisdiction over an inter-vivos trust if any controversy or problems arise, just as it does for a testamentary trust.
- The funding of a testamentary trust can often be up in the air because the actual funding doesn't take place until your death. Just as with other parts of your will, if your circumstances have changed and property you had anticipated using for the trust no longer is in your estate or is worth far less than it once was, you and the trust's beneficiaries may be out of luck because, quite simply, the necessary funds aren't available.

TIP

To help prevent unpleasant surprises, such as an underfunded or even unfunded testamentary trust, review all aspects of your trust when you do your annual review of your will. (After all, the provisions for a testamentary trust are contained in your will, so doing so is only logical.) If the property you had planned to use to fund the trust is no longer worth enough to accomplish your goals, then you can look for additional property in your estate and adjust your will accordingly, change the details of the trust to reflect a reduced value, or in the worst case, cancel your plans for the testamentary trust.

Deciding if an inter-vivos or testamentary trust is better

Which is better for your estate plan: an inter-vivos trust or a testamentary trust? The favorite answer of estate-planning professionals: It all depends! As with most other aspects of estate planning, you and your estate-planning team need to look carefully at many different factors to put strategies and instruments in place that are specific to your needs.

Inter-vivos trusts, together with plain old gift giving (see Chapter 11), are a good way to reduce your estate's value and reduce or negate the effect of federal estate taxes. And, as we mention earlier in this section, you can give early and give often with an inter-vivos trust, benefiting people or institutions sooner than if they had to wait for your death.

TECHNICAL STUFF

Check out the "Step right up" sidebar in Chapter 2, where we discuss the negative income tax ramifications to your recipients for gift giving while you're still alive versus inheritance after you're gone, thanks to the difference between the *carry-over basis* versus the *stepped-up basis.*

On the other hand, suppose you only want a trust to come alive if you die before a certain age and you want to make provisions for your minor children's care, education, and so on. You can use a testamentary trust as part of your will. If you live long enough so your children are no longer minors and are out on their own and don't need to have money parceled out, you can revise your will and eliminate the testamentary trust provisions.

TIP

Our advice: If you do a good job at outlining your objectives for setting up a trust in the first place, the most appropriate category of trust — inter-vivos or testamentary — is fairly obvious along with the particular type of trust we discuss in Chapter 8.

Changing your mind: Revocable and irrevocable trusts

An inter-vivos trust — again, a trust you set up that goes into effect while you're still alive — can be either:

- *Revocable,* meaning you can change your mind
- *Irrevocable,* meaning sorry, what's done is done

Irrevocable trusts are the easier of the two to understand. After you place property into an irrevocable trust, you can't retrieve the property. For all intents and purposes, that property now belongs to the trust, not to you! If you put your home into an inter-vivos irrevocable trust, but continue to reside in the home, you may have just broken a rule that could have consequences you weren't expecting, like leaving that property available to creditors to take if you can't pay all your bills!

With a revocable trust, however, you can place property into the trust and at some point in the future, undo the transfer by removing the property and terminating the trust.

TECHNICAL STUFF

Very often, if you die or become incompetent, the provisions of a revocable trust call for the trust to become an irrevocable trust. Consider a revocable *burial trust* as an example, which you can terminate at any time, usually before death or incompetency. However, if the burial trust is still in existence when you die (or become incompetent), the trust becomes irrevocable and the money is used for your funeral expenses.

The most significant distinctions between revocable and irrevocable trusts are the estate tax considerations. Property that you place in an irrevocable trust is no longer considered part of your estate, meaning that the property typically isn't included in your estate's value when it comes to determining if you owe death taxes and, if so, how much. However, you still own property that you place into a revocable trust, and, therefore, that property is still subject to death taxes. (If you can change your mind about the trust and retrieve the property from the trust at any time while you're still alive, the property is really yours and should be considered part of your estate.)

WARNING

You most likely have gift tax consequences when you establish an inter-vivos irrevocable trust, so make sure your accountant is in the loop, along with your attorney. Also, certain transfers within certain time periods prior to your death can be included in your estate as "gifts in contemplation of death" under both state and federal statutes. So, watch out for possible death tax implications!

If you only get a break on estate taxes with an irrevocable trust, why would anyone want to use a revocable trust without the estate tax break? Recall that earlier in the chapter, we discuss how estate tax savings is only one of the reasons you may consider including a trust in your estate planning. If your estate's value is nowhere near the federal estate tax exemption amount magic number, then you really don't need to be concerned about federal estate-tax-saving tactics — for now, anyway. Your motivation for setting up a trust may have more to do with estate protection or helping out a charity, but you also may want a safety valve that allows you to pull money out of a trust if circumstances change in some way.

WARNING

Make sure to work with your accountant to understand any and all tax implications — income (including capital gains), gift, federal estate, and state inheritance or estate — for property transfers to both irrevocable and revocable trusts. They can help you set up the right provisions and avoid unpleasant tax-related surprises from the government because of some provision of the tax code you didn't know about.

LOOKING CLOSELY AT REVOCABLE TRUSTS

Estate-planning advisers often point to revocable trusts — particularly living trusts (see Chapter 6) — as "the perfect way to totally avoid probate." Put all your property into revocable trusts, and you can have control over that property, the pitch goes, and because none of your property is now in your probate estate (that is, it's all held in trust), your estate doesn't have to go through the probate process because your probate estate is "empty!" And, by avoiding probate, you avoid the costs of probate, the lack of privacy, and the other disadvantages to the probate process we discuss in Chapter 5.

Not so fast! True; you can avoid probate costs, but do you really think setting up and maintaining trusts is free? No way! Your costs to set up a revocable trust vary depending on attorney fees and other charges but be prepared to pay to have your trust managed.

You also need to make sure that everything you own is held in trust form. If you fail to include any part of your estate in your trust(s), then you have a probate estate that is subject to the probate process. So, every time you buy a new home, open a new brokerage account, or make any changes to the your estate's inventory, you need to make sure that you transfer that property into your trust(s). Can you say, "What a pain"? Sure, we knew you could!

Remember also that probate isn't always bad either. The probate court, which has the responsibility of making sure that property in your probate estate is disposed of properly with no behind-the-scenes funny games, supervises your probate estate. Without the probate court's supervision, part or all of your estate that is held in trust or other nonprobate form (joint tenancy with right of survivorship, for example) can be in for problems if someone close to you in a position of authority has, shall we say, a lack of ethics. Eventually, all the beneficiary problems may get straightened out, but quite possibly because of prolonged, costly legal battles.

Also, keep in mind that you may be required to file state or federal estate or inheritance tax returns, even though you have no "probate estate" (or "probate assets"). At the state level, at least, those returns are usually considered to be public records. Therefore, if privacy concerns are important to you, your desire for privacy may be defeated.

IN THIS CHAPTER

- » Getting hitched to a marriage trust
- » Considering whether a charitable trust makes sense
- » Deciphering protective trusts
- » Understanding grantor-retained and irrevocable life insurance trusts

Chapter 8

Trusts You May Want to Trust — or Not

When it comes to trusts, not only do you need to trust (pun intended!) your estate-planning team, but you also need to have at least some understanding of the various types of trusts that are available to you. Chapter 7 shows you how trusts work. This chapter is your handy reference on the kinds of trusts people use the most in estate planning.

If, for example, you want to start giving gifts to your minor children, you can ask your estate-planning adviser about minor's trusts. Or if you want to give something to your favorite charity, you can read about charitable trusts and find out the differences between a *charitable lead trust* and a *charitable remainder trust.*

We explain the basics in this chapter and prepare you for an informed discussion with your estate-planning advisers.

TIP

We encourage you to focus in this chapter on trusts specific to your own circumstances. For example, if you're not married and you don't plan to be before you take on your estate planning, you can completely skip over the first section regarding marriage-oriented trusts because they only help you if you're legally married. Similarly, if there aren't any charities you want to support, a charitable trust may be of no use or interest to you and your estate plan, so you can skip that section.

Saying "I Do" to a Marriage-Oriented Trust

In this section, we assume that you're married and that you'll die before your spouse does — nothing personal, it's just an example. (If you're not married, feel free to skip this section.)

One of the most popular uses for all trusts is to buy time on paying any applicable estate taxes until both spouses in a marriage have died, or to skip over your spouse for purposes of transferring property but still give your spouse the right to income from a trust. This section covers your options.

Marital deduction and QTIP trusts

A *marital deduction trust* allows you to put property in trust with your spouse as the beneficiary. Upon your death, your spouse has the right to use the property in the trust. No matter how valuable the property in the trust is, even if it exceeds that year's federal estate tax exemption amount (see Chapter 13 for a discussion of the exemption amounts), your spouse won't owe any federal estate taxes.

Later, upon your spouse's death, the leftover amount, if any, transfers to the beneficiaries that your spouse determines.

Suppose, though, that you want to determine who receives the trust property after your spouse dies? (Again, assume that you're already dead when your spouse dies.) Consider instead using a *qualified terminable interest property trust,* commonly known as the *QTIP trust.* (We can't help but wonder how many hours went into thinking up that name just to get that acronym.) A QTIP trust (feel like you need to clean your ears out yet?) operates much the same as a marital deduction trust, with one important exception: You, not your spouse, specify who receives the remaining property in the trust after your spouse dies.

When should you consider using a marital deduction trust instead of a QTIP trust, or vice versa? Consider the following: Suppose you and your spouse were only married once (to each other); you have a happy, contented marriage; and both of your children act like they stepped right out of a 1950s TV show like *Leave It to Beaver.* You both want the other person provided for no matter who dies first, and you both want to set up some type of a trust to delay or diminish federal estate taxes, but then after the second spouse dies, you both want the remainder to go to your children.

In this case, a QTIP trust and a marital deduction trust would probably work equally well, because you both agree (at least for now) about how you eventually want to distribute the remaining property in your estates. If you set up a marital deduction trust and you die first, your spouse can later designate your two children as equal beneficiaries of the property left in the trust. Or perhaps one of your two children makes millions of dollars in business or in the stock market or maybe even cryptocurrency (don't laugh — it may happen again someday!); your spouse can decide to leave the entire leftover estate to the other child who wasn't quite so fortunate or skilled. Whatever the rationale, a marital deduction trust allows the beneficiary-designation decision to be delayed as long as possible.

Now consider the following, however: Both you and your current spouse are on your second marriages, and you both have children from your first marriages. You and your spouse's first-marriage children (to put it delicately) don't quite see eye to eye. The word *freeloaders* comes to mind every time you hear their names, but your spouse thinks of those first-marriage children as angels.

Regardless of your not-so-positive relationship with your spouse's children, you and your spouse have a happy marriage, and you want to provide for your spouse if you die first. And, because you both are fairly well off financially, a marriage-oriented trust makes sense to delay estate tax impacts.

But do you want your spouse to decide what happens with any leftovers from your estate upon their death, as would be the case in a marital deduction trust? Probably not. In this case, you want a QTIP trust, in which you designate what happens to those leftovers. After all, this estate is yours, and for all intents and purposes, you're just "loaning" it to your second spouse for the duration of their life if you die first. Afterward, you want the leftovers to go to *your* children, *your* favorite charity, basically *anyone* but your spouse's children from that first marriage, which is what may happen if you leave the decision to your spouse by using a marital deduction trust.

Bypass trusts

Another way for a married couple to shelter property from estate taxes is to use a type of trust sometimes referred to as a *bypass trust* because of the way the trust works, as we explain in a moment. Suppose, as in the examples in the preceding section, that you die before your spouse does, but instead of either a QTIP trust or a marital deduction trust, you've set up a bypass trust.

Instead of the property being held in trust for your spouse (as in a QTIP or marital deduction trust), the property in a bypass trust "bypasses" your spouse (hence, the reason for the often-used term) to someone else, such as your child, for whom the property is held in trust. However, unlike the relatively simple process of giving property to your child as a gift or leaving your child property in your will, your spouse can still benefit from the property under a bypass trust. Although the property is held in trust for the ultimate benefit of your child, your spouse (while living) can have the benefit of the trust assets.

Because your spouse never takes possession of the property in a bypass trust, they never are considered to be the property owner and, therefore, never have to include the property in their estate — and possibly be subject to estate taxes on the property. Along the way, the trust agreement that you set up for the bypass trust spells out all the rules that you want followed: how much interest will be paid to your spouse and when, for example.

TECHNICAL STUFF

An incredible number of rules apply to bypass trusts and, specifically, the estate tax consequences. The Internal Revenue Service (IRS) has all kinds of restrictions. In order to determine the exact amounts you want to use to fund a bypass trust, consider the exemption amounts, your estate's value, the value of your spouse's estate, and other factors. Rather than even attempt to go into all this detail — which we could write an entire book on by itself — we recommend that you work very carefully with your estate-planning team not only in setting up a bypass trust (like all other trusts), but also in deciding which type of trust (a bypass trust, QTIP trust, or marital deduction trust) makes the most sense for you and your spouse.

Considering Charitable Trusts

In Chapter 11, we mention how you can give gifts to qualified charitable organizations and take advantage of the charitable deduction to avoid gift taxes. Another way to leave property to charitable organizations, particularly on a time-release basis, is to use some type of *charitable trust.*

There are two main types of charitable trusts:

- **Charitable lead trusts:** You can use a *charitable lead trust* (a type of irrevocable trust) to make a series of payments (for example, an *annuity* of the same amount each year) to a charitable organization. At some point in the future, the remaining property in the trust:
  - Reverts back to you
  - Transfers to someone else you specify, such as your spouse or your child
- **Charitable remainder trusts:** When you place property in a *charitable remainder trust,* your beneficiary receives a specified amount of money

regularly for a period of time. After that period of time has elapsed, whatever is left over goes to the charity.

Instead of some finite period of time, you can set up a charitable remainder trust to cover the life of your beneficiary. When the beneficiary dies, the payments end.

Many people set themselves up as the beneficiary who receives the payments from the trust, but you can also specify your spouse, your children, or someone else to receive those payments. If you specify anyone other than your spouse or yourself to receive the payments from the trust, gift taxes most likely apply, unless the payments are under the $17,000 annual exclusion for 2023 that we discuss in Chapter 11. The payments are considered to be a gift. (Gifts to your spouse don't trigger the gift tax because those payments are treated the same as if they were gifts with the unlimited marital deduction, as we also discuss in Chapter 11.)

WARNING

If you're trying to reduce your estate by using a charitable remainder trust and specify your spouse to receive payments, you may be increasing the value of your spouse's estate when estate taxes eventually kick in or, if they already apply, they may be higher than they otherwise would. As with all the other estate-related tax strategies we discuss elsewhere in this book, you need to think several moves ahead and discuss any foreseeable down-the-road complications with your accountant.

EVERYBODY INTO THE POOL!

Chances are, your college alma mater or a charity has pitched a *pooled interest trust* (even if not identified as such by that name). They tell you that you can make a donation and receive interest back on that donation for some period of time, such as until you reach a certain age.

Your contribution is *pooled* (lumped together) with other contributions from other people. You don't have to take on any expenses for setting up some type of charitable trust, but at the same time your options for the trust are limited and established by the charitable institution themselves.

Now you know the estate-planning basis for that pitch from dear old State U.!

Protecting Your Estate with Protective Trusts

You can use a *protective trust* to protect your beneficiary's property. The following sections discuss the different types of protective trusts:

- Spendthrift trusts
- Supplemental needs and special needs trusts
- Education trusts
- Minor's trusts

Spendthrift trusts

Several times in this book we use an example of setting up a trust to parcel out money to the trust's beneficiary instead of giving that person a whole lot of money all at once. Essentially, the reason a spendthrift trust is considered to be a protective trust is that it protects the beneficiary from themselves.

The rules that apply to a spendthrift trust are rather straightforward. The beneficiary (for sake of this example, your somewhat spoiled kid, no matter how old they may be) can't touch any of the property in the trust; they only own the payments that have been made.

Additionally, your little angel's creditors can't seize the property in the trust. The creditors can, of course, go after the money in dribs and drabs as it comes out in payments to your offspring, but they can't grab the entire property itself.

TECHNICAL STUFF

Despite the spendthrift provisions that keep creditors at bay, the courts allow certain types of claims (alimony and child support, for example), which you need to consider when setting up the trust.

Supplemental needs and special needs trusts

God forbid you become disabled or incapacitated and need extensive personal care in your lifetime. But if you do need long-term treatment, you already know that the cost can be ferociously high. One serious and extended hospital or nursing home stay can wipe out your life savings.

GETTING TECHNICAL ABOUT SPENDTHRIFT TRUSTS

In addition to a spendthrift trust, you can specify spendthrift provisions on other types of trusts, such as a *discretionary trust.* With a discretionary trust, the trustee (the person in charge of the trust) has vast and far-reaching powers (to get a bit overdramatic) to control the trust's payments to the beneficiary or beneficiaries. Included in those "vast and far-reaching powers" is the discretion to make no payments at all!

For people with an estate — remember, that's most people — how do you protect your assets from seizure by state government if you're receiving assistance for your long-term care?

In Chapter 17, we discuss different types of insurance (long-term disability and long-term care). In Chapter 19, we also discuss issues of guardianship and the durable power of attorney, and how both apply to incompetent or incapacitated people.

But we also discuss in Chapter 10 how the Estate Recovery Act may cause the government to go after part or all of a person's estate after death if that person received certain types of government assistance. In addition to insurance, you also need to consider whether a *supplemental needs trust* or *special needs trust* makes sense for your estate planning.

TECHNICAL STUFF

A supplemental needs trust is designed to support a disabled, elderly, or handicapped person in such a manner as to not jeopardize or reduce that person's eligibility and qualification to receive private or public benefits, such as Medicaid. Furthermore, a supplemental needs trust also protects the assets in the trust from creditors' claims. The supplemental needs trust adds funds to cover the beneficiary in addition to the public or private funds.

If your disabled beneficiary receives state medical assistance and is under the age of 65, a *special needs trust* repays the state. You place property in the trust and a trustee manages it, for the benefit of the beneficiary, just like the typical trust. However, instead of providing income to the beneficiary, the trustee makes payments as required to reimburse the state for care it provides. At some point in the future, often after the beneficiary dies, any remaining balance is paid to other beneficiaries (often other family members).

TIP

Essentially, the trustee repays the state as the beneficiary uses the services, instead of reimbursing the state in a lump sum after death under the Estate Recovery Act. Either way, you need to have both long-term disability and long-term care insurance as part of your overall estate planning to help protect you and your estate if you become seriously injured, incompetent, or incapacitated.

Educational trusts

As you can guess from the name, an *educational trust* provides payments to the beneficiary for education-related needs: tuition, books, supplies, and so on. Educational trusts usually contain provisions that halt payments if, for example, the beneficiary drops out (or flunks out) of school.

You can use an educational trust for a single beneficiary — your oldest child, for example. Alternatively, you can set up a single educational trust for all your children, your children and grandchildren, your nieces and nephews, or any other combination of beneficiaries that makes sense.

TIP

When you talk with your advisers, make sure to cover the following items:

- What happens to any leftover funds in the trust?
- What happens if nobody from the beneficiary list decides to go to college?
- What happens if everyone on the beneficiary list receives full scholarships and nobody needs the money?
- When does the educational trust terminate?

You have several alternatives for each of the preceding questions and many others, so ask your estate-planning team members for advice based on their experience with other educational trusts. Also, ask about any worst-case situations so you can avoid those same problems!

Minor's trusts

You use a *minor's trust* to establish funds for someone who worked in the coalmines.

No, we're not serious! We just wanted to see if you were still hanging in as we continue through this long list of different types of trusts. (Besides, a trust for someone who worked in the mines would be called a "miner's" — spelled differently! — trust.)

A minor's trust is a way for you to make gifts to minors (for example, your three children, ages 5, 7, and 10) and still take advantage of the annual exclusion from gift taxes ($17,000 per person in 2023, as we discuss in Chapter 11).

TECHNICAL STUFF

Be careful, though: The gift must be something that you actually own at the time you give it, not something that you expect to receive or earn at some point in the future but that you might not actually get.

When the minor reaches majority (age 18 in most states), the property in the minor's trust becomes theirs, because they're no longer a minor. (Happy birthday!)

GRAT, GRUT, GRIT: Chewing over the Grantor-Retained Trusts

You can create a trust that pays you a fixed amount of money at regular intervals. That's a grantor retained annuity trust (GRAT). You can create a trust that pays you a specified percentage. That's a grantor retained unit trust (GRUT). Or you can create a trust that allows you to transfer ownership of certain assets but retain the income or use of that property during the trust. That's a grantor retained income trust (GRIT).

Earlier in this chapter, we discuss the charitable remainder trust, in which you create a trust containing property that eventually goes to a charitable organization. But along the way, income from that trust or use of property in that trust (a house or building, for example) either comes back to you or some other beneficiary you specify in the trust agreement.

GRATs, GRUTs, and GRITs give you a way to create a "noncharitable" variation on the theme. By *noncharitable*, we mean that instead of the property in the trust eventually going to a charitable organization, the property goes to (for example) your child or your favorite cousin.

WARNING

Grantor-retained trusts are irrevocable (see Chapter 7), so think and plan carefully before putting one in place.

The primary difference among the varieties of grantor-retained trusts is how the income you receive is determined. In general financial lingo, an *annuity* typically refers to a fixed amount of money, and a GRAT pays you an annuity from the trust.

In contrast, a GRUT pays you some specified percentage of the trust rather than a fixed amount. So, with a GRUT instead of a GRAT (stay with us!), your payments likely vary from one year to another, depending on the property's value in the trust, which is affected by any earnings (or losses).

The third type — the GRIT — is useful if you want to place your family home in trust and still keep living there. Part of the income applicable to the trust is your right to live in that house.

TECHNICAL STUFF

To be extremely precise, placing your house in trust and continuing to live in it is actually a *qualified personal residence trust,* which is a specific form of a GRIT that's still permitted under current tax law. Other older GRIT varieties no longer are permitted, but estate planners often use GRIT and qualified personal residence trust interchangeably, even though the latter is technically only one form of a GRIT. Why? Estate-planning advisers do so most likely to keep with the common acronyms (GRAT, GRUT, GRIT) and to prevent too much alphabet soup and complicated terms from slipping into the estate-planning vocabulary (and confusing their clients).

With all three types of grantor-retained trusts, after the trust goes away, the property in the trust transfers to the beneficiary. Again, instead of a charity (as with a charitable trust), that beneficiary often is a relative.

WARNING

The tax laws for all the varieties of grantor-retained trusts are extremely complicated! For example, you and your beneficiaries may need to worry about gift taxes and estate taxes. At the same time, you may realize some tax savings depending on factors, such as the value of the property you place in trust and changes in that property's value. Not only do you need to work with your attorney when deciding if a grantor-retained trust is for you (and if so, what type), but also you need to make sure you work with your accountant to clearly understand all the tax consequences — for you and for your beneficiary.

Sidestepping Estate Taxes with an Irrevocable Life Insurance Trust

WARNING

Beware of the life insurance tax trap! In Chapter 17, we discuss how various forms of life insurance are likely to be an important part of your estate planning, from protecting your estate to creating cash that goes to one or more of your beneficiaries. However, the tax laws dictate that the death benefit from your life insurance policy gets added into the rest of your estate when calculating your estate's value and the amount of federal estate tax you owe. You should also check the laws in the state where you live to see if life insurance is included in a taxable estate. As a result, you must look ahead to various tips and tricks to help get around this tax trap!

One common way to get around estate taxes on your life insurance is to create an *irrevocable life insurance trust.* You transfer the ownership of your life insurance policy to the trust, effectively taking advantage of a loophole to get around estate taxes.

If you think an irrevocable life insurance trust makes sense in your situation, be aware of the following:

- As the name implies, your life insurance trust must be irrevocable — otherwise, goodbye estate tax break! As we discuss in Chapter 7, with a revocable trust, you can change your mind about the trust, or the property in the trust (or whatever is left over) transfers back to you. In order to qualify for the estate tax break, the trust has to be irrevocable. After the trust owns the life insurance policy, you can never get it back or make any changes!
- You can't be the trustee of an irrevocable life insurance trust that contains your own life insurance policy, even though you don't own the policy (the trust does).
- You need to act now! The IRS also says that if you set up an irrevocable life insurance trust but die within three years of the transfer of the life insurance policy, then the IRS acts as if the trust never existed and you still owned and controlled the policy. And then, you lose the estate tax break.

TIP

Another estate tax saving strategy for your life insurance policy, instead of an irrevocable life insurance trust, is to transfer ownership of the policy to someone else, as we discuss in Chapter 17. The secret recipe is for the IRS to agree that you didn't own and control the policy, which means you get an estate tax break! But note that the same three-year period for the gift inclusion will apply.

TECHNICAL STUFF

You may inadvertently trigger income tax consequences if you violate the *transfer-for-value rule*, which means that if you transfer a life insurance policy in exchange for money, property, or anything of value, then a portion of the death benefit will be subject to taxation as ordinary income. So, be careful and make sure you dot all your *i*'s and cross all your *t*'s when you transfer the ownership of a life insurance policy as part of your estate-planning strategy.

WHAT A CRUMMEY DEAL!

If you don't own and control your life insurance policy because it's owned by an irrevocable life insurance trust, how can you pay your premiums to keep the policy in effect? You can, of course, have someone else pay the premiums for you — your spouse or the beneficiary of the policy, for example. Or you can set up a *Crummey trust* to take care of the payments.

Crummey trusts are very complicated and best explained by your estate-planning attorney doing a TV announcer diagramming a football play, showing how money transfers back and forth, how the gift tax annual exclusion applies, and all kinds of pretty complicated rules and restrictions. But if you and your estate-planning team decide that an irrevocable life insurance trust makes sense for you and your beneficiaries, ask whether a Crummey trust makes sense, too.

IN THIS CHAPTER

» Getting started on your estate-related tax planning before beginning your trust planning

» Analyzing your goals and objectives

» Identifying candidate property for trusts

» Looking at both trust and nontrust ways to achieve your goals

» Finalizing your choices

Chapter 9
Working a Trust into Your Estate Plan

How can you make sense out of the vast number of trusts available for your estate planning? Many of them have similar names but are subtly different from each other. (Quick: What's the main difference between a charitable lead trust and a charitable remainder trust? And, more important, which makes sense for your estate plan? See Chapter 8 for the answer.)

Not only do you need to decide among similar-sounding and similar-functioning trusts, you also need to decide if you even need any trusts at all for your estate plan. In many cases, you have two main courses of action, one that involves trusts and one that doesn't involve trusts. If you're beginning to think that a lot of the same objectives can be accomplished with a will or other legal move, you're actually partially right. Trusts are fairly sophisticated parts of your estate plan, but as we've said repeatedly, your legal advisers might be taking care of the nuts and bolts, but you need to be aware of the tools you have in your toolbox.

So, we ask the question again: How can you make sense out of all this trust business?

Help is on the way! In this chapter, we present some disciplined steps to help you make sense out of trusts, figure out which ones — if any — are right for you, and if so, how to get your trusts underway.

Linking Your Estate-Related Tax Planning with Your Trust Planning

WARNING

Don't even think about creating a trust — any type of trust — unless you've already started your estate-related tax planning. Your estate-planning team may already be on the tax topic. But if not, take a quick look at Chapter 14 where we discuss the approach you need to take for estate-related tax planning.

Many states have an inheritance tax, which takes a piece of most property you may want to leave to someone when you die. Even if you aren't fortunate to have the millions of dollars' worth of property to trigger the federal estate tax, you may be costing your family money when you're gone by not using a trust.

You will find, however, reasons unrelated to taxes to use a trust. Avoiding probate and all the court forms is one reason to use trusts; basically, the quest for simplification.

The initial steps of your estate-related tax planning are exactly the same ones you need to complete before even thinking about trusts. Specifically, you need to:

- Assess your current financial and estate picture, starting with inventorying your estate and determining its value today.
- Look into the future and, as best you can, try to predict what your estate will look like and what it'll be worth at various points in the future.

You conduct these two preceding acts primarily for your estate-related tax planning, so we discuss the details of each in Chapter 14. However, one of the primary reasons to consider trusts is so that you can avoid, diminish, or at least delay estate-related taxes — if your estate is valuable enough that various types apply. If your estate isn't valuable enough to be impacted by federal estate taxes and if you live in a state that doesn't have a state estate tax or an inheritance tax, you may not need to give much consideration to tax-oriented trusts.

So make sure that you begin your trust planning in concert with your death tax planning. If you've already done your death tax planning, then take the next step. But if you haven't yet begun death tax planning, then go no further with your trust planning until you shift gears and start looking at your estate from a tax liability point of view.

Looking at Your Goals and Objectives for Setting Up Trusts

In Chapter 7, we mention five primary goals and objectives that may cause you to consider trusts for your estate:

- Reducing or avoiding estate-related taxes
- Steering clear of probate
- Protecting your property until you die when that property passes on to your family
- Providing money for education
- Benefiting charitable organizations

Some types of trusts directly relate to one of the listed objectives (charitable trusts to provide for charitable organizations is fairly obvious), and also have characteristics that secondarily meet other goals on the list.

But you first need to look at your goals and objectives before worrying about which trusts satisfy which objectives. Based on linking your death tax planning with your trust planning, you now have a pretty good idea how vulnerable your estate is to various types of estate-related taxes. If your estate is very vulnerable, then you certainly want to look at various techniques to reduce or avoid estate taxes, such as a charitable trust. In contrast, if you're not the charitable type, you probably shouldn't waste any time looking at various types of charitable trusts. True, some of them may have tax-savings properties, but if your favorite characters from the movies and literature are Scrooge and The Grinch (of Dr. Seuss fame), you may find better and more tax-saving trusts without all the "bother" of that charitable nonsense! (Bah, humbug!)

REMEMBER

Even if your estate is not vulnerable to estate-related taxes, you need to consider the possibility that the large federal estate tax exclusion may change from time to time.

We also recommend that you take a second — and even third or fourth — look at some of your long-standing objectives to understand just how important they really are to you. For example, in order to avoid probate, we discuss in Chapters 5 and 6 that probate can be a nuisance and you have a variety of will substitutes (joint tenancy with right of survivorship, for example) to keep certain property out of your probate estate. But how important is avoiding probate? For example, do you want to go to the trouble and expense of placing every piece of your property in some type of nonprobate form, including one or more trusts? Or are you satisfied keeping some or even most of your estate in nonprobate form (again, including trusts)?

Finally, protecting your estate property — particularly keeping the property safe when your beneficiaries, such as your children receive it — may be extremely important to you. But suppose you don't have any children or other beneficiaries to whom you plan to leave substantial amounts of money? Most likely then, you don't have to worry about trusts whose primary objective is protecting your estate when it passes to your beneficiaries.

So, make sure you have a clear idea of which trust-oriented estate-planning objectives are important to you and which ones aren't.

Deciding What Property to Place in Trust

In theory, you can put every single piece of your property in a trust. But in practice, concentrate your efforts on putting your property where you can get the most bang for your buck. After all, trusts cost money to set up and administer, and you need to worry about finding the right trustee. You also have to make other decisions, such as whether the trust takes effect while you're still alive (an *inter-vivos trust*, as we discuss in Chapter 7) or upon your death (*a testamentary trust*, also discussed in Chapter 7). You also need to decide if you want a trust to be revocable or irrevocable (whether you can "change your mind" about a trust — see Chapter 7), and because some trusts are only one or the other, you often need to search around to find the right type of trust.

But do you really want to go through all this work for every asset in your estate? We didn't think so! Instead, you may want to consider a trust for only some portion(s) of your estate assets. In deciding whether to consider some type of trust, focus your efforts in four main areas:

- Your life insurance policy or policies
- Real property, including your primary residence, vacation homes, and any real estate investments that you intend to hold for many years
- Intangible personal property, such as bank accounts and stocks, that you plan to transfer to someone else while you're alive or after you die — basically, money that you don't intend to use for yourself

» Property in your estate of any type — real property or intangible personal property, as we previously list, but also tangible personal property (your antiques, for example) that you intend to transfer to a charitable organization

Most of the trusts that we discuss in Chapter 8 are most effective and provide the most benefit when the property used to fund the trust falls into one of the preceding four categories. So, don't worry that every item on your 25-page estate inventory needs to be placed into trust. Focus on the areas that give you the most benefit.

Linking Your Estate-Planning and Trust Goals with Specific Property

A significant part of your estate planning is to answer the beneficiary question: Who gets what? You may transfer some of your property while you're still alive, and other property upon your death. You made a lot of decisions when you completed your will (see Chapter 3), as well as when you set up certain will substitutes (see Chapter 6).

Now you want to take a second look at all your beneficiary decisions and match them with your specific trust-related objectives. For example, why exactly are you setting aside $75,000 for your nephew while you're still alive? If you're doing so to help pay for his college education, that's a great gesture, but what happens if your nephew decides not to go to college or begins college and later drops out? Do you still want him to have the money?

The reason you need to link your goals and the who-gets-what picture for your estate planning is so that when you compare your trust and nontrust options, you can make the right choices for how to transfer property — or, in some cases, how *not* to transfer property.

Stepping Back and Comparing Both Trust and Nontrust Options

Don't be in such a big hurry to start setting up all kinds of trusts! In many cases, nontrust options may be better suited for what you're trying to accomplish. (Many times nontrust options cost less and are less of a hassle.)

Continuing with the same example, suppose you plan to set aside $75,000 for your nephew. Suppose also that whether or not he goes to college, you want him to have that money at the age of 21. You can set up a simple *minor's trust* that eventually contains $75,000 from your annual below-the-gift-tax-radar contributions (see Chapter 8) that pays income to your nephew while he's a minor, with the provision that your nephew can start drawing principal from that trust when he's 18 if he goes to college; otherwise, when he turns 21, the money is his.

Alternatively, you can set up an *education trust* that eventually contains $75,000 by the time your nephew goes to college — if he goes to college. If not, the trust agreement specifies "no college, no money" and the trust principal may be "diverted" to some other relative or perhaps donated to a university.

But you can also simply set aside money in your own bank account and if your nephew goes to college, you can pay his tuition free of gift taxes because of the education exclusion (see Chapter 11). No trusts involved!

The point is that after you decide what property to transfer to whom — along with when those transfers take place and under what circumstances — only then should you start looking at which type of trust may work for you. Furthermore, you also need to look at whether techniques that don't involve trusts may be equally suited or even better suited to what you're trying to accomplish.

Here's another example: Suppose you want your favorite charity to have $500,000. You can simply give the charity the $500,000 at any point and use the charitable deduction to avoid gift taxes. Or, if you want to wait until your death for the $500,000 to go to the charity, simply leave the $500,000 in your will.

You can also set up some type of charitable trust, such as a charitable lead trust or charitable remainder trust (both of which we discuss in Chapter 8). Or you can set up any other type of trust with "strings attached" that makes annual payments as long as the charity continues to meet certain requirements. Again, you have many options — trust- and nontrust-related — available to you.

And are you worried about estate-related taxes taking a chunk out of your life insurance death benefit? Consider an irrevocable life insurance trust (see Chapter 8). ***Remember:*** You can also just give the policy to someone else and not bother setting up a trust, at least for your life insurance!

In Chapter 8, we discuss how you need to be careful about the *transfer-for-value rule* for life insurance to avoid accidentally triggering taxes.

WARNING

For each beneficiary decision that you're examining to see if a trust makes sense, you need to look at all the tax consequences — not only gift- and estate-related, but also income and capital gains — to make sure you don't fall into any tax traps. Work with your accountant who understands all the tax laws.

BEWARE OF THE PITCHMEN!

As you consider whether trusts make sense for your estate, watch out for scenarios that seem to describe your particular situation as the "perfect reason" for using this trust or that trust.

We absolutely encourage you to do your estate-planning homework, and we guarantee that you'll come across some type of pitch along the lines of "Bob is a 50-year-old married man with two children and a total estate of $1.2 million. Bob's house is worth $600,000, blah, blah, blah. (A few more blah, blah, blahs. . . .) Bob needs to set up a Thingamajigger Trust for his house and a Doohickie Trust for his stock account, and. . . ."

In some cases, these scenarios are little more than sales pitches from estate-planning professionals trying to sell you something — trusts, mostly. But even if the scenarios are genuine and aren't part of a sales pitch, you still need to be careful! "Bob" in the scenario may sound pretty similar to you, but does the scenario mention if Bob's parents are still living and if so, what their respective health situations are? Does Bob have an incapacitated brother he's taking care of, as you do? "Scenario Bob" may be encouraged to set up education trusts for his daughter, but suppose that your daughter of the same age was accepted to the Air Force Academy or West Point and will start next fall, with all her college tuition and expenses covered by the appointment?

As we mention throughout the book, estate planning is very much an individualized exercise. Not only is your estate plan likely to be different from your neighbor's, but it's likely to be different from "scenario people" who on the surface seem to be just like you. By all means use examples from scenarios as ideas to bring to your estate-planning team, but treat those ideas as just that — ideas — rather than an edict ordering you to set up this type of trust or buy that kind of insurance policy.

Weighing Trust Trade-offs

Even when you're fairly certain that a trust makes sense for a particular aspect of your estate planning, take at least one more look at the various options you have to make sure you choose the right one.

For example, in Chapter 8, we discuss both marital deduction trusts and qualified terminable interest property (QTIP) trusts, along with bypass trusts. All three are marriage-oriented trusts with the primary purpose of helping you with an estate tax problem (that problem being too much federal estate tax, of course!). However, all three operate differently from one another, so you need to think carefully about which one makes sense.

Depending on your particular family and circumstances, one type may be perfectly suited while another type may be an estate-planning nightmare! (See our examples in Chapter 8, particularly those involving a second marriage.)

As another example, look at the different types of charitable remainder trusts and grantor-retained trusts that we discuss in Chapter 8. Do you want to receive a fixed amount of money each year from the property you've placed in trust or a percentage of the trust's principal (and consequently a varying amount of money) each year? Do you want to set up your own charitable remainder trust or lump your contribution in with other people's contributions in a pooled interest trust?

Decisions, decisions, decisions . . . hey, we didn't say these decisions were easy! If you've reached the point where you're trying to decide if you want your grantor-retained trust to be a GRAT, GRUT, or GRIT, then congratulations! You've reached this point by following a very disciplined, well-thought-out course of action rather than looking at a list of different types of trusts and thinking, "I'll have one of these and two of those."

Finalizing Your Choices: Dotting the I's and Crossing the T's

At this point, you're ready to finalize your trust choices (as well as your nontrust choices, if you've decided against using a trust).

Now is the time to sit down with your estate-planning team to finalize your list of trusts and fill in those last details you still need to decide. Do you want the trust to go into effect while you're still alive or upon your death? Do you want the trust to be revocable, or are you comfortable with it being irrevocable?

As we point out in Chapter 8, some trusts are only revocable and others are only irrevocable. Other trusts only make sense if they're *inter vivos* (in effect while you're still alive), while other trusts may be better as *testamentary* trusts (taking effect upon your death).

You need to fill in the blanks for each trust and decide what property to place into trust, who the trustee is, who the beneficiary or beneficiaries of each trust are, what all the provisions of the trust agreement are, and so on.

TIP

Think of this step as a dress rehearsal for the trust portion of your estate plan. Now you can make last-minute adjustments because your estate-planning team (think of your team members as you would a play's director) takes a front-to-back, top-to-bottom look at the entire trust plan in concert with your estate-related tax plan and your total estate plan.

This step also includes the paperwork! As your attorney sets up each trust, you need to fill in lots of blanks on many sheets of paper, and double-check lots of fine print.

TIP

If you're setting up a number of trusts as part of your estate plan, don't do them all at once! For example, do your irrevocable life insurance trust first (because the clock is running; see Chapter 8 for the three-year consideration), and then perhaps shift gears to the charitable trust for a charity that really needs funding badly! Then maybe set up an educational trust for your children or grandchildren, and then shift gears again to whatever type of marriage-oriented trust you want to set up for tax purposes.

Take your time with each trust agreement, and indeed with your trust plan as a whole. You don't want to make any serious mistakes, especially with an irrevocable trust that can't be changed!

4

Life, Death, and Taxes

IN THIS PART . . .

Get ready to (maybe) share your estate with the tax folks from the government.

Explore the link between estate taxes and gift taxes.

Use generation-skipping transfer taxes to limit your estate tax bill.

Figure out how much of a hit the death tax will take on your estate.

Draw up a plan to minimize your overall estate tax burden.

IN THIS CHAPTER

» Understanding the "big three" federal estate-related taxes

» Figuring out if you have to pay state inheritance or estate taxes, too

» Defending hearth and home against the Estate Recovery Act

Chapter 10
Preparing for the Tug-of-War with the Taxman

The Beatles' famous 1968 hit song "Taxman" makes a dead-on-the-mark commentary about death, your estate, and taxes. George Harrison's lyrics astutely point out that the government firmly believes in the old saying, "You can't take it with you." So, the taxman figures out ways to grab whatever he can — even the pennies holding your eyelids shut!

In this chapter, we give you an early warning about various types of estate-related taxes that you need to factor into your estate planning. We introduce you to the *federal tax triangle* of estate tax, gift tax, and generation-skipping transfer tax. And because the federal government may not be alone in wanting a big cut of your estate — depending on where you live — you may have to worry about state inheritance or estate taxes. We present an overview of those considerations as well. Finally, we introduce you to an important *sort-of tax* — the Estate Recovery Act — and some considerations for you if you ever need to tap into government-provided health care at some point in your life.

Navigating through the Bermuda Triangle of Federal Taxes

The Bermuda Triangle, as you recall, is that stretch of ocean where ships and airplanes have disappeared without a trace. The federal tax system has its own Bermuda Triangle — a trio of taxes that work together to make as much of your estate as possible disappear without a trace. They are

- » The gift tax
- » The generation-skipping transfer tax (GSTT)
- » The estate (death) tax

But just as with the Bermuda Triangle, you can counteract this mysterious force by planning ahead and, basically, understanding what you're facing.

REMEMBER

If you don't have a very valuable estate, the various federal taxes may not apply to you — at least for now, which could always change along with future changes in tax law. (See the exemption amount "magic numbers" in Table 13-1 of Chapter 13 to figure out if, for federal estate purposes, your estate is "valuable.") But you or those beneficiaries who survive you still have a substantial amount of tax-related paperwork to file, so you're not totally in the clear even if you don't actually have to pay any of the taxes.

But you may very well find yourself dealing with at least some of the estate-related taxes, and you need to know what you're up against. In Chapters 11 through 13, we discuss the federal gift tax, the GSTT, and the federal estate tax. To introduce you to these taxes, we provide a very brief discussion in the following sections, and suggest that you spend time with the more detailed discussion of each in Chapters 11, 12, and 13 as you find yourself needing to know more. And even if some of these taxes are not currently applicable to your estate plan today, tax laws and their corresponding applicable exemption amounts do change, and they may become applicable to you — and your estate plan — in the future. Therefore, you really do need to have a basic knowledge of these various estate-related taxes.

WARNING

The folks who wrote the laws and rules for the federal estate tax, gift tax, and GSTT created some confusing relationships among the three taxes. You absolutely, positively want to use the experts on your estate-planning team — particularly, your accountant and your attorney — to help you make sense of the odd relationships among these taxes.

The gift tax

Confusion around the *gift tax* starts with the name itself. The federal gift tax is imposed on taxable gifts that *you* give to *others*, not on gifts that you receive. The premise behind the gift tax is fairly straightforward. If you try to avoid estate taxes by giving away a significant portion of your estate while you're still alive, the government applies a tax on those gifts — sort of a "Pay me now because you're not going to be paying me later!" approach.

The sort-of-good news is that you have a variety of exemptions and allowances to work with in your gift giving to help you minimize the actual tax bite or even escape the tax bite completely in some cases. Also, even if you make taxable gifts, you may not ever have to actually pay gift taxes (that is, to actually write a check for the amount you owe) because you can credit the amount of gift tax you owe against any down-the-road estate tax after you die.

You can find the particulars of the gift tax in Chapter 11.

The generation-skipping transfer tax

The GSTT closes a loophole that the upper class has used to reduce estate taxes. Briefly, the story goes like this: Members of very wealthy families who have a strong desire to keep as much wealth within their family as possible can use a variety of tactics to help shelter family wealth from a tax bite. For many years, wealthy people directly transferred some of their property to members of lower generations — for example, to their grandchildren rather than their children.

The idea was that if, for example, a wealthy grandparent gave or left lots of money to their own children who were wealthy in their own right, then they'd never need to spend that money — and most of what the grandparent gave as gifts or left in their will was taxed. Then, when the grandparent's children died, that same money that they didn't need to spend or otherwise get rid of once again was taxed when it was passed to their own children. So, the grandparent thought ahead and just gave or left the money directly to the grandchildren or set up certain types of trusts, and essentially the money was taxed (for estate purposes, not for income purposes) only once instead of twice because the grandparent had cleverly skipped over an entire generation within their family.

TECHNICAL STUFF

For purposes of when the GSTT kicks in, the recipient needs to be *more* than one generation younger than the donor (such as a grandchild) *or* 37.5 years younger than the donor if an unrelated party. The recipient of the gift is called a *skip person.* (And no, that doesn't mean that if a grandchild isn't nicknamed Skip, the GSTT doesn't apply!)

Think of the GSTT as "closing the generation-skipping loophole" (at least, GSTT proponents position and explain the tax that way) by adding an additional tax — and at pretty hefty rates! — to property transfers that can be classified as generation skipping to make up for the amount of tax that you're trying not to pay.

The good news, though, is that you have a sizable exemption amount to work with, and you can work with your attorney and accountant to minimize the GSTT bite. And you really do want to minimize the GSTT, which is currently taxed at 40 percent above the lifetime exemption amount! That's a lot your estate would need to pay! In Chapter 12, we explain the basics of the GSTT, but we caution you in Chapter 12, and we caution you now: The GSTT is very complex and when you get beyond the basics, you definitely need to work with qualified, experienced professionals on your estate-planning team if you have a sizable estate and could conceivably be subject to the GSTT. In other words, as they sometimes say on TV, "Don't try this at home!"

WARNING

The 2022 exemption amount is a sizable $12.06 million, which has increased significantly over the years. This amount will continue to increase annually based on inflation through 2025. However, this exemption amount, similar to the estate tax we discuss in the next section, will *decrease* significantly (get cut in half) to a projected $6+ million. From there, the exemption amount is scheduled to begin increasing — but as we keep mentioning, this is a prime "tax-hunting area" for Congress to add revenue to offset a record national debt. So, be aware that this exemption amount could potentially decrease way, way back down to the $1 million level where it was at the beginning of this century (yep, like more than 20 years ago!).

The estate (death) tax

Everyone absolutely, positively needs to worry about the federal estate tax, no matter how big (or small) their estate is. Even though none of us has any idea of how long we're going to live, both major and minor future changes to tax law can't be ignored.

TECHNICAL STUFF

If you died in 2010, for the first time in almost 100 years, there was no estate tax regardless of the size of your estate. Short-lived estate tax jackpot — but only for a single year! Not to miss out on tax revenue, in 2010, Congress passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act (referred to more simply as the Tax Relief Act, or TRA), which reinstated the estate tax and applicable tax percentage of what's owed on the value of your estate over the exemption amount. So, in a three-year period, the $3.5 million estate value exemption in 2009 was followed by the "perfect year to die" unlimited exemption in 2010 and was then followed by the decrease to $1 million exemption in 2011. Talk about head-spinning!

So, you need to worry about the federal estate tax if for no other reason than you're dealing with a continually moving target. And you have no guarantee that new tax laws won't be passed sometime, or anytime, in the future yet again!

As of the writing of this book, there are proposed legislative changes to reduce the estate exemption amount to $3.5 million, accompanied by an increase in the maximum tax rate to 45 percent. Under the current estate tax exemption, a $6 million dollar estate would have zero estate tax in 2027 when the current exemption amounts will be cut in half. But under this proposed legislation, that same $6 million dollar estate would owe an estate tax of over $1.1 million!

And there you have it: the perfect (in a bad way!) example of future changes that are *not* favorable to your potential estate tax burden. Suppose lawmakers pass another law (like the one currently proposed), where the estate tax rates increase instead of decrease and exemption amounts go down instead of up — the result being higher estate taxes for everyone. You never know!

TIP

But before we all worry about what may happen in the future, first focus on the federal estate tax rules as they stand now. Chapter 13 goes into detail about the estate tax and what you need to know.

Deciphering State Inheritance and Estate Taxes

Depending on where you live, your state inheritance and estate tax situation will be one of these four scenarios:

- No estate-related taxes at all — lucky you!
- A state estate tax, which operates much the same way as the federal estate tax does. A tax is imposed on your estate's value and is paid out of your estate (typically, by your personal representative).
- A state inheritance tax, which actually taxes your beneficiaries on what they receive, rather than the estate itself. Don't forget that the primary responsibility for filing the inheritance tax return and paying the tax usually falls on the personal representative.
- A *pick-up* or *soak-up tax,* which is a "sort-of tax." Your estate doesn't actually owe any additional money to pay that tax, even though a state estate tax return likely needs to be filed. The state gets a cut of what would otherwise be paid to the IRS (but your personal representative still probably has to file a lot of state tax paperwork anyway!).

REMEMBER

Some states are repealing or phasing out their inheritance or estate taxes as another way to attract baby boomer retirees, but other states that currently don't have estate-related taxes may institute either an inheritance tax or an estate tax! Whereas most state governments had budget surpluses throughout the 1990s, the COVID-19 pandemic and inflation era of the 2020s have been quite a different story, with deficits coming back as a result of economic slowdown. As a result, states are looking to all kinds of new or increased sources of revenue to help cover shortfalls — so why not estate-related taxes?

TIP

Keep alert wherever you live, and if you see either a state estate or state inheritance tax coming, work with your accountant and attorney to adjust your estate planning as necessary.

Additionally, pay attention to the details of any existing inheritance or estate taxes that may apply where you live, such as your state's tax-rate structure. For example, your state may impose different inheritance tax rates on different people, depending on their relationship to you (for example, parents and children in one group or class, other relatives in a second class, unrelated people in a third class, and so on).

TIP

Also, don't forget about any exemptions your state has, such as excluding life insurance, pensions, or fixed dollar amounts for different classes of recipients. You definitely need to work with your accountant and the rest of your estate-planning team.

Another topic about state death taxes you need to be aware of is the soon-to-disappear credit on your federal estate tax return (IRS Form 706) for any state estate taxes that you have to pay. Whereas most of the 2001 tax law helps with lower tax rates and higher exemption amounts, one part of the 2001 tax law can cost you (or, more accurately, your estate) more money if you live in a state that has a state estate or inheritance tax.

WARNING

Even if you don't live in a state with a state estate tax, part of your estate may still be subject to a state death tax! How? If you own property (specifically, real estate) in another state, estate or inheritance tax may apply for your out-of-state property if the state where the property is located does have death taxes. Make sure your accountant knows if you have any out-of-state property so you can factor that into your estate plan.

Protecting Your Property (Including Home Sweet Home!) from the Estate Recovery Act

The Estate Recovery Act technically isn't a tax, but because it involves the government trying to take money out of your estate after you die, we include it in this discussion of various estate-related taxes.

In 1993, the U.S. Congress passed an act that requires each state to demand repayment for Medicaid benefits that had previously been provided to certain citizens for certain services. Specifically:

- **Certain citizens:** People over the age of 55 who have received Medicaid payments within a specified period of time
- **Certain services:** Payments for nursing homes and nursing-care facilities, home- and community-based services, related services at hospitals, and prescription drugs

The idea behind the Estate Recovery Act is simple (but devious): If you need to accept help from Medicaid for health-care services, you have no problem while you're still alive. But after you die, the government wants its money back!

WARNING

In fact, the Estate Recovery Act can have a far more devastating impact on your estate than any estate tax does! We explain why in this section.

The Estate Recovery Act can be the most detrimental tax (or sort-of tax), because the people most likely to require Medicaid assistance are people who probably have the least property or assets. Chances are, most of what they do have is in their respective houses or residences. So, guess what the government will go after for reimbursement when a "targeted" person dies? You guessed it: the family home!

However, your state may have some type of homestead exemption or personal residence waiver to protect your house if you ever need Medicaid and fall within your state's guidelines to seek reimbursement after you die. For example, your house may be safe as long as your spouse is still alive, and only after your spouse dies will the state try to pursue a forced sale if no other assets are available for reimbursement. You also can look into other estate-planning and gift-giving strategies to protect your house, such as joint tenancy (see Chapter 6 for more information about the *right of survivorship* aspect) if you want to protect your house because, say, one of your children lives there.

TECHNICAL STUFF

The particulars of each state's version of the Estate Recovery Act — and the names they go by — vary, but chances are that your state's version may not apply to property that passes to others outside of probate (that is, your *nonprobate estate*). Your nonprobate estate may include property in which you and someone else (or more than one other person) have joint tenancy with right of survivorship (see Chapter 6).

TIP

Strategies to avoid the Estate Recovery Act in the first place include long-term-care insurance, removal of assets subject to the probate process, and an annuity that transfers right to a surviving spouse. Discuss these options with your estate attorney as countermeasures to the Estate Recovery Act.

TIP

Make sure you spend time with your attorney going through all the details of your state's version of the Estate Recovery Act. For example, find out when the state will seek repayment. For example, the state may wait until your surviving spouse (if any) has died, your children have grown, or some other factors. Your state may also have other exemptions (such as a below-the-poverty-line exemption), or you may be allowed to apply for a waiver.

WARNING

Make sure you tell your personal representative that they may be personally liable for Estate Recovery Act–related claims! Specifically, if your personal representative transfers property to others (such as family members) without first satisfying a claim for recovery from your state, the state can come after the personal representative for payment. And if you're someone else's personal representative, make sure you know whether the person's estate that you are a personal representative for is subject to a claim by the state. Not following the rules (or not paying attention) can be very costly!

Your attorney can explain all the rules governing personal representative responsibility to you, both for your own estate as well as any personal representative responsibilities you have for someone else's estate. For example, you need to know how long the personal representative has to notify the department in the state government that administers the state's recovery plan, and how to actually do the notification (for example, by certified letter). Our advice: Be careful and pay attention!

A HELPING OF PHILOSOPHY WITH A SIDE ORDER OF IDEOLOGY

Make no mistake about it: Various kinds of estate-related taxes involve much more than laws and rules, calculations and numbers. The battle lines are drawn between opponents and proponents of estate taxes, gift taxes, and generation-skipping transfer taxes, and the two sides may as well be the opposing armies at Gettysburg in 1863!

Opponents of estate-related taxes make arguments like these:

- The property in your estate has been "taxed on the way in." For example, the income you earned from your job or business was subject to income taxes and shouldn't also be "taxed on the way out" because doing so represents double-taxation of the same property.
- Much of the increased value of property in your estate, such as interest you earn on your bank accounts and certificates of deposit, also has been taxed along the way. So, why tax what you have left over yet one more time?
- Owners of family businesses and farms are especially hard hit by estate taxes and often have to sell part or all of their businesses to raise cash to pay estate taxes.
- What's so wrong about keeping hard-earned wealth within your family rather than "turning it over" to the government?

On the other side of the battle, estate tax proponents argue that:

- In many estates, particularly those of wealthier individuals, much of the value has *not* already been taxed (specifically, gains on stocks, real estate, and other property).
- Family businesses and farms actually have the use of special credits and deductions to help defray the tax impact.
- Keeping large amounts of wealth concentrated in your family is "socially bad." After you die, your heirs and beneficiaries should be willing to give up some of that family wealth for "the greater social good" because, after all, they didn't earn that money, you did — and now you're gone!

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Unlike the Civil War, where less than two years after Gettysburg the two opposing forces had reconciled, don't expect the opposing sides of the estate-tax battle to come to agreement. You're likely to see a seesaw battle of philosophy and ideology for years to come. For example, the overall reductions in tax rates, increases in exemption amounts, and repeals found in the 2001 tax law can certainly be viewed as the handiwork of opponents of estate-related taxes. But on the other hand, the sunset provision cuts some of these tax exemptions in half by 2026, potentially increasing the tax bite on your estate.

The battle continues.

IN THIS CHAPTER

» Understanding gifts and the gift tax

» Looking inside the gift tax

» Valuing gifts

» Filing gift tax forms

» Calculating the gift tax

Chapter 11

The Gift Tax: Isn't Giving a Gift Enough?

Think about this idea: If your estate is worth enough to be subject to federal estate taxes after you die, why not transfer some — or maybe even all — of the property in your estate to others while you're still alive to avoid federal estate taxes? Basically, why don't you just give everything away in the form of gifts?

REMEMBER

In the estate-planning world, "gifts" are a bit more significant than, say, that tie you gave your dad last Father's Day, or season tickets to your brother's favorite sports team that you gave him last year. In fact, make that "a lot more significant" in terms of value. We're talking about stocks, mansions, boats, and even large amounts of cash that you might try to give away while you're still alive to stay a few steps ahead of estate taxes.

Unfortunately, the federal government has already thought about this strategy and has stayed one step ahead with the gift tax. In fact, those sneaky tax guys went a step further. The government linked many aspects of the gift tax with the federal estate tax to further limit your ability to avoid paying taxes when you transfer your property to others — while you're still alive, as well as after you die.

TECHNICAL STUFF

When we wrote the first edition of this book a long time ago, the federal estate tax was scheduled to go away entirely in 2010. However, that didn't happen. Bad news, right? Well, here's some counterbalancing good news: Unless you have a *lot* of assets (more than $10 million presently, according to the tax tables), you most likely don't even need to think about handing out high-value gifts as part of your plan to reduce estate taxes (because the gift may reduce your estate to be below the threshold of being subject to estate taxes).

WARNING

However, you still need to be aware of the *gift tax* because even something as seemingly harmless as buying your grandson a new car could trigger the gift tax, depending on how much the car is worth. Now why might that be? Because there are people who work for the government whose only job is to make sure every penny of tax that should be paid is actually paid. Those people got Congress to change the law years ago to discourage you from giving your stuff away while you're still alive, which would result in the IRS not being able to charge your heirs taxes on what they receive after you die. To close what you may think of as a "gift loophole," the government wrote laws and rules that made the gift tax and estate tax work together to make sure all the taxes they would get if you die tomorrow don't somehow evaporate by your giving stuff away before you die. In fact, the end result is that the value of what you give away is still counted for calculating estate taxes when you die, with certain exceptions.

TIP

Still, despite the potential bite of gift taxes, gift giving can be an important part of your overall estate planning. In this chapter, we present you with enough basic information about the gift tax so you can understand the tax implications of the gifts you give. And we also help you understand the implications of gift giving and the associated taxes for your estate. Because of the linkage between gift and estate taxes, you absolutely need to think several moves ahead, just as if you were playing chess, to understand the long-range impact.

Giving a Gift: The Basics

At the simplest level, the gift tax is very straightforward, and works like this:

1. **You give a gift to someone.**
2. **You determine if the gift you gave is taxable.**
3. **If the gift is taxable, you check for exceptions, credits, or exclusions that can help make part or all of the gift tax-free.**
4. **You keep track of your gifts and, at some point, compare those amounts against the limitations the government set for gift and estate taxes, as part of your overall estate planning.**

WARNING

This chapter discusses the federal gift tax system. A few states also impose a state gift tax. Check to see if your state has a state gift tax before deciding the potential gift tax liability from gifting.

There are gifts — and there are taxable gifts

In the world of estate planning, gifts are more complex than the presents you give and receive on birthdays and at other holidays. Don't think in general terms of a gift, but rather in terms of *taxable gifts of property* from your estate.

REMEMBER

Property can be real property (such as your house), tangible personal property (such as a car or an antique painting), or intangible personal property (such as shares of a mutual fund). Turn to Chapter 1 for more information on property types.

So, how can you tell when a gift is taxable and subject to a gift tax? The most common situation you'll run into is giving property (including money) that exceeds the annual exclusion (in 2023, that's $17,000, as we discuss in a moment) and doesn't qualify for any of the deductions — marital, educational, and so on — that we discuss later.

If your gift qualifies under the preceding definition and you don't receive anything of value for the amount above the exclusion, you've made a taxable gift for the amount above that exclusion. For example, if you give your son $14,000 in cash and expect nothing in return, the portion exceeding the annual exclusion amount is a taxable gift. But if you give your son $14,000 in cash and receive $14,000 worth of gold in exchange, the cash isn't a gift.

TECHNICAL STUFF

Additionally, to be considered a completed property transfer and, therefore, a gift, you must give up all control of the property.

A little bit of good news, though, is that each year you have a certain amount called an *annual exclusion* that works in your favor. The annual exclusion is very simple: For every person to whom you give a gift, you have a limit on the amount you can give. For example, in 2023, the annual exclusion is $17,000, so any gifts you give to someone up to a total value of $17,000 aren't subject to the gift tax for that year. (We discuss more about the annual exclusion, including how it applies when you give gifts to more than one person, later in this chapter.)

The tax guys didn't stop at simply applying gift taxes to transfers of valuable property. You may also make a taxable gift if you

- Sell property for less than its fair market value. (We discuss this topic more in the section, "Valuing Gifts.")

- Make a reduced interest rate loan.
- Make an interest-free loan.
- Forgive part of the balance of a loan you made. For example, if you loan $100,000 to your son to buy a house and — being very generous — you later decide to reduce the balance to $85,000, you just gave him a $15,000 gift.

TECHNICAL STUFF

The person who gives a gift is called the *donor*, while the person receiving the gift is called the *donee.* An easy way to remember these terms is to think about an organ donor — the donor gives away an organ just like a donor gives a gift. The *transfer date* is the date that the property actually transfers from the donor to the donee. The gift's value on the transfer date is called the *transfer value.*

Not all gifts are taxable

Even if the gift's value exceeds the annual exclusion, certain gifts are excepted. These exceptions include gifts to:

- Your spouse (because of the marital deduction)
- Most charities (because of the charitable deduction)
- Political organizations (because of the political exclusion)
- Tuition (because of the educational exclusion)
- Medical expenses (because of the medical exclusion)

BEFORE YOU ADD THE KIDS TO YOUR CHECKING ACCOUNT . . .

Many elderly people decide to add their adult children to their bank accounts so their children can help them pay bills. Most states' signature cards for these accounts treat the addition of the child to the bank account as a joint tenant with right of survivorship (see Chapter 6). Either party — the parent or child — can then withdraw funds.

If the child just signs their name to the checks for bill paying, no taxable property transfer occurs. But if the child withdraws money for their own use and hasn't contributed to the account, the gift tax law treats those amounts as taxable gifts.

The marital deduction

You can transfer an unlimited amount of property to your spouse. For example, if you give your spouse $1 million, you've made a taxable gift. But due to the marital deduction, you don't owe any gift tax.

However, you need to meet certain qualifications in order for the marital deduction to be unlimited and tax-free:

- You and your spouse must be married at the time the gift is completed.
- The spouse receiving the gift must be a U.S. citizen.
- The spouse receiving the gift can't have a *terminable interest,* which means that your spouse's interest in the property being transferred as a gift ends when "something" happens in the future (such as a certain date arriving, or maybe your mother-in-law moving in with you).

The charitable deduction

One of the most common forms of estate planning to avoid gift taxes is charitable giving. As with the marital deduction, the amount you give to a charity tax-free is unlimited. You can give any type of property as a charitable gift. So, if you're very wealthy and you want to be remembered as a great philanthropist, you can gift your favorite charity $10 million and not deal with gift taxes! Take note, though, that the gift might still be subject to a limitation based on your adjusted gross income (AGI) in the year that you make the gift, so make sure that you check the most current tax laws.

TECHNICAL STUFF

Generally, you must give your entire interest in the property as part of your gift to be eligible for the charitable deduction; the technical term used is a *total interest charitable gift.*

The amount of your charitable deduction depends on which of the following four types of gifts you give. All are considered to be total interest charitable gifts:

- **Total charitable gift:** The most common type of charitable gifting, when you give the property (including cash) to the charity and receive a charitable deduction. You make this type of charitable gift and expect nothing in return.
- **Charitable bargain sale:** You sell property to the charity at less than fair market value (see the section, "Valuing Gifts," later in this chapter) and then receive a charitable deduction on the difference between the property's sale price and property's fair market value. You can use bargain sales for small-value property where you want to give a gift but also want something in return.

- **Charitable stock bailout:** These types of gifts enable you to give closely held stock and receive a charitable deduction equal to the stock's fair market value. You receive a charitable deduction by giving shares, and at the same time you avoid paying the income tax or capital gains tax that you otherwise would've owed had you redeemed or sold those shares. This strategy may make sense as part of your overall tax planning.
- **Charitable gift annuity:** You transfer property to a charity that agrees to pay someone a specified amount for the remainder of that person's lifetime. As a result, the charity keeps the remaining amount of the annuity after you die. The amount of charitable deduction is based on who is named as the lifetime donor.

WARNING

The charity must be considered a *qualified* charity to avoid gift taxes. The IRS publishes a list of qualified charities. Most public charities qualify, but double-check before writing that very large check!

Political exclusions

If you're really passionate about politics and you want to put your money where your vote is, we have good news: Gifts to political organizations are exempt from gift tax. (So, you can try to buy political influence and avoid gift taxes too — what a country!)

Educational exclusions

On the education front, to qualify for an educational exclusion, a gift must be:

- Earmarked for tuition or training
- Paid directly to the educational institution

So your check payable to the University of Knowledge for tuition qualifies for an educational exclusion, but what about if you give your nephew a check to be used for his tuition? Sorry, you can only use the education exclusion if you make the check payable directly to the educational institution. (Maybe the tax law writers figured that unless the gift check goes directly to a school, students may use the money for other purposes, such as a spring break trip to Cancun.)

Medical exclusions

Medical exclusions apply for payments made to a medical care facility for costs (such as diagnosis and treatment), as well as payments for a person's medical insurance. Make payments directly to the medical institution to qualify for the medical exclusion.

Looking Inside Three Common Gift Tax Situations

To see how the gift tax may affect you, we examine three examples.

Example #1: $5,000 to darling daughter

Suppose you've never given any taxable gifts previously, and in 2022, you decided to give a cash gift of $5,000 to your oldest daughter. In 2023, when you file your tax returns you aren't subject to the gift tax.

You aren't subject to gift tax because the gift amount ($5,000 in this case) is lower than the annual exclusion amount. In 2022, the annual exclusion amount was $16,000.

TIP

Every year the federal government resets the annual exclusion indexed for inflation. In 2023, the annual exclusion amount is $17,000, so you can give your daughter a gift of $17,000 and that entire gift is free of gift taxes. Check with your accountant every year to find out if the exclusion amount has increased before you give any gifts.

Example #2: $7,000 each to all three adorable kids

Suppose you've still never given any taxable gifts previously, and in 2023 you decide to give $7,000 to each of your three children for a total of $21,000. Even though the annual exclusion for 2023 is $17,000, you don't owe any gift tax. The annual exclusion amount applies to each person to whom you give a gift. So, because no single gift was more than $17,000, each of your gifts — all $21,000 — is not subject to the gift tax.

Think of the annual exclusion as actually being a collection of annual exclusion amounts, one for each person to whom you give a gift. Nobody's annual exclusion spills over into anybody else's, giving you flexibility in how you decide to divide gifts among various recipients. So, basically, if you have 15 (gasp!) children, you can give each child up to $17,000 worth of gifts and not have to pay any gift tax.

TECHNICAL STUFF

To be eligible for the annual exclusion, gifts must be for *present interest,* meaning that the person receiving a gift must be able to enjoy and use the property now. Gifts of *future interest* — meaning the one's use of the gift doesn't begin until some future date or is, in the lingo of estate planning, "otherwise incomplete" — don't qualify for the annual exclusion.

Example #3: $21,000 to the fairest of them all

Suppose you've never given any taxable gifts and in 2023 you give a gift of $21,000 to your oldest daughter. In this case, you do have to pay a gift tax, because the $21,000 has exceeded the $17,000 annual exclusion by $4,000. So, you may owe a gift tax on $4,000 (not on the entire $21,000 gift).

But this situation can be complicated. By using the current tax rates (remember, though, that tax rates change often, so double-check the current rates with your accountant or tax attorney), the gift tax owed is $800 based on a 20 percent tax rate. But you may not have to actually pay $800 in taxes out of your pocket — at least right now.

The reason you may not have to actually pay $800 is because of how the gift tax and the federal estate tax are linked. You have a *magic number* that determines whether estate taxes apply to your estate after you die. In 2023, this magic number is a pretty large amount of $12,920,000. The magic numbers (you may see either of the following more formal terms used: *exemption equivalents* or *exclusion amounts*) for other years are shown in Table 11-1.

TABLE 11-1 Basic Exclusion Amount for Year of Death

Year of Death	Basic Exclusion Amount
2011	$5,000,000
2012	$5,120,000
2013	$5,250,000
2014	$5,340,000
2015	$5,430,000
2016	$5,450,000
2017	$5,490,000
2018	$11,180,000
2019	$11,400,000
2020	$11,580,000
2021	$11,700,000
2022	$12,060,000
2023	$12,920,000

Exclusions

The annual exclusion amount for the year of gift is as shown in Table 11-2.

TABLE 11-2 **Annual Exclusion per Donee for Year of Gift**

Year of Gift	Annual Exclusion per Donee
2011–2012	$13,000
2013–2017	$14,000
2018–2021	$15,000
2022	$16,000
2023	$17,000

For basic exclusion amounts, see Table 11-1.

TIP

The IRS's website (`www.irs.gov`) is a good place to get the current figures, especially the next time tax law changes affect estate and gift taxes (and you can be fairly certain that'll happen again!).

Gift Splitting

The old adage says that in marriage you share and share alike — which in the world of gifts is good, because *gift splitting* essentially allows you to double the annual exclusion amount. You and your spouse can share a gift by considering that you give one-half of the gift and your spouse gives one-half of the gift. For example, in 2023, you and your spouse could give $34,000 (the $17,000 annual exclusion × 2) to anyone annually without making a taxable gift.

Suppose you and your spouse give $17,000 to your nephew and $20,000 to your niece in 2023. By gift splitting, you and your spouse are considered to each be giving $8,500 ($17,000 ÷ 2) to your nephew and $10,000 ($20,000 ÷ 2) to your niece. Even though the total gift value to your niece is more than the annual exclusion amount of $17,000, gift splitting enables you to make *both* gifts nontaxable.

TIP

You need to follow a few simple rules when it comes to gift splitting to prove that both you and your spouse are in agreement on the gift splitting that you're doing in any particular year. Check with your accountant to see what tax return forms you need to file and when.

Valuing Gifts

REMEMBER

We discuss ways you can value the various types of property in your estate in Chapter 2.

If you're trying to get a general idea of what your estate is worth so you can decide who you want to leave various property to, you don't need to worry about being precise. For example, whether your house is worth $187,000 or $187,500 — or even $190,000 — doesn't make a whole lot of difference when you're doing basic estate planning.

But in order to determine if a gift tax may be owed on a gift, you need to precisely determine the gift's value. Sound easy? Well, sometimes it is and sometimes it isn't. When you buy a gift for someone, you think of the gift's value as the price you just paid for the item. If you buy a $1,000 painting as a gift, your gift's value is $1,000. But what if the painting doesn't have a price tag? How can you determine value? And how do you standardize your gift's value so all the same gifts have the same value?

Valuation is an important part in the calculation of gift tax. If your gift is determined to be a taxable gift subject to gift tax, you need to know the gift's value in order to determine the tax amount. Some common methods are covered in the following sections, and by all means, work with your accountant to make sure you correctly and accurately determine the value of gifts.

Fair market value

The most common valuation technique in the federal gift tax is *fair market value.* The fair market value of property is determined by what the property receives in value in a market comprised of (to use some terminology from basic economics) willing and able buyers and sellers.

TECHNICAL STUFF

For fair market value, buyers and sellers under U.S. Treasury regulations enter into the market with "neither being under any compulsion to buy or sell." So, the free market exchange between buyers and sellers determines fair market value.

How important is fair market value? If you believe that you don't need to file a gift tax return (covered later in this chapter) because the property's fair market value is less than the annual exclusion, the IRS can challenge and contest the fair market value at any time in the future — even on the donor's estate tax return submitted after death! But if you do file a gift tax return, the IRS has three years to challenge and contest the property's fair market value. You (or your estate) must prove the fair market value. If you can't, the IRS will establish that value.

TIP

If the determination of a gift tax depends on identifying fair market value, how do you actually figure out the fair market value? After all, you know the old saying, "All is fair in love and market value." You determine fair market value differently depending on the type of property, as we discuss in the following sections.

Real property

For gifting purposes, real property, such as your house, vacation home, or investment income-producing property is valued in the same manner we discuss in Chapter 2.

REMEMBER

In order to get an independent valuation on real property, you may need to hire an appraiser. Your real property's fair market value is most likely not the price you paid for it because real estate prices change — hopefully, increasing rather than decreasing! Fair market value is the amount your property is worth today.

The appraisal looks at factors, such as:

- Recent sales prices of comparable properties
- The property's replacement cost
- Income value from income-producing property
- The property's location and condition

Publicly traded stocks and bonds

Unlike real property, a readily available price tag is attached to publicly traded stocks and bonds. For example, if a share of XYZ Company stock is $44 on Tuesday, the fair market value of a share is $44; if the share price increases to $45 on Wednesday, the fair market value of a share changes to $45. In fact, throughout days when the stock market is open, you can get real-time prices for stocks.

Because of the ease of obtaining the fair market value of publicly traded stocks and bonds, the calculation of fair market value for purposes of gift taxes is straightforward; however, you should be aware that the fair market value for gift tax purposes is the mean of the highest and lowest sales price on the date of valuation.

TECHNICAL STUFF

You always wondered if math skills and statistics would ever come in handy. Now's your chance! A mean is the same as an average and is calculated by adding the set of numbers and dividing it by the amount of numbers in the set. For example, if the XYZ Company shares on the date of valuation reached a high of $48 and a low of $42, the mean valuation is $45 ($48 + $42 = $90 ÷ 2 = $45).

Closely held stock

Unlike publicly traded stock, which can have thousands or millions of owners, only a few individuals hold closely held stock. Typically, family businesses may have only a few family members as owners of all the shares of stock, so the business is deemed to be *closely held.*

If fair market value is determined in a market with buyers and sellers, how do you value closely held stock that has no sellers and in essence no buyers but possibly the other co-owners?

Factors in determining fair market value for closely held stock include the following:

- Business type
- Industry outlook
- Financial capabilities of business
- Fair market value of comparable publicly traded stock

TECHNICAL STUFF

Even after you determine the fair market value of closely held stock, you still have a situation where your stock isn't part of the free market exchange that is an essential part of fair market value. The IRS sometimes allows special discount techniques that reduce the value of closely held stock to less than fair market value in determining the value of gifted closely held stock for gift tax purposes. The lower the fair market value, the less you potentially owe in gift tax.

Special valuation techniques other than fair market value available for closely held stock are:

- Minority discount
- Lack of marketability discount

If you own less than 50 percent of a closely held business, you have a minority ownership in the business. Consequently, you probably don't have the ability to set or change policy in a closely held business because of your minority ownership position. Due to the many regulations regarding minority discounts, check the requirements before using a minority discount for closely held stock.

A *lack of marketability discount* acknowledges that you may have difficulty finding a buyer for a closely held business, such as a partnership or corporation. In addition to not having the exposure to buyers that you do with publicly traded stock, the closely held business may have restrictions on who can even buy your stock.

Savings bonds

You probably have some good old savings bonds lying around somewhere that a relative gave you or that you purchased through a payroll deduction plan at work.

You can determine the transfer value of savings bonds by knowing the amount that you can redeem the bond for on the transfer dates, which is called its *redemption value.* ***Remember:*** A bond cashed in prior to its maturity date receives a discounted value. So, a savings bond with a face value of $20,000 gifted prior to its maturity date has a transfer value that is less than $20,000. Tables published by the government provide redemption values for bonds.

Co-ownership property

In Chapter 6, we cover several ways that you and others can co-own property: joint tenants with right of survivorship, tenants by the entirety, and tenants in common. Tenants by the entirety and community property are forms of ownership only for spouses, while anyone can use tenants in common and joint tenancy. Additionally, we discuss community property in Chapter 4 as another way of co-owning property.

If you co-own something, you only own a part of it and, therefore, have only a partial interest in the property. So, how do you figure out the fair market value of part of a property for gift tax purposes? Your figure depends on which form of co-ownership you have.

For example, with tenants in common, the gift's value is the fair market value of the percentage owned on the transfer date. So, if you own 35 percent of the property you gift, the transfer value is 35 percent of the property's fair market value.

In the case of joint tenancy with right of survivorship, because all joint tenants own equal shares, the gift's value is proportionate to your ownership. So, for example, if you're one of four joint tenants, the transfer value is 25 percent of the property's fair market value.

To find out the specifics about fair market value and co-owning property, ask your accountant or tax attorney. Also, ask those estate-planning professionals about specific concerns for gifting partial interest in real estate to family members, such as when an elderly parent adds a child to the deed for the parent's home.

Filing Gift Tax Forms

As if dealing with a tax on gifts isn't enough, as a donor you get the pleasure of filing a tax form associated with the gift tax. After all, taxes and forms go together!

The gift tax return is known as IRS Form 709. You must send in Form 709 by April 15 of the year after you made the gift. If you owe a gift tax, you must pay it no later than April 15 (though most people will pay the tax at the same time that the return is filed, even if that date is before April 15).

TIP

If you file for an extension on your income taxes, you automatically receive an extension for your gift tax return because both are due on April 15. Just check the box on the income tax extension form indicating your intention to also extend the gift tax return date. ***Note:*** If someone dies more than nine months prior to April 15, the gift tax form needs to be filed at the same time as the estate tax return.

WARNING

Even if you've become very comfortable in doing your own income taxes each year, you may want to work with your accountant on gift tax returns, especially if you've previously given taxable gifts and you now have to use prior years' figures for total gifts and gift taxes (as we discuss earlier in this chapter). You don't want to unwittingly make a mistake that can eventually cause more estate taxes to be paid after you die. Basically, if you make mistakes on your gift tax form that cause you to show more of your unified credit used than is actually the case, the consequences for your eventual estate tax return can be a whole lot of trouble for your personal representative to straighten out.

You must file a gift tax return using IRS Form 709 if:

- You give anyone (except your spouse) more than the annual exclusion amount in a calendar year.
- You give anyone (except your spouse) a gift of a future interest rather than a present interest.
- You give your spouse a gift that terminates in the future and, thus, doesn't qualify for a marital deduction.
- You give a charitable gift exceeding the annual exclusion amount and the gift doesn't qualify for a charitable deduction.
- You give a charitable gift exceeding the annual exclusion amount that qualifies for a charitable deduction, but you give less than your entire interest in the property.

WARNING

If you are required to file IRS Form 709 but miss the deadline — or don't file Form 709 at all — the IRS will whack you with a 5 percent penalty *per month* of the tax you didn't pay. The IRS does cap the penalty at 25 percent of the unpaid tax, but you could still wind up with a hefty tax penalty bill, so pay attention to the filing deadlines.

TIP

If the only reason you're filing a gift tax return is because of gift splitting and not because your gift exceeds the annual exclusion, you may be able to use Form 709-A, which is simpler. Check the other requirements listed on this form to make sure you can use it.

Now the big question: Who is responsible for paying the gift tax owed? The answer is usually the donor. If you gift split with your spouse, each of you is responsible for paying the gift tax associated with your own return.

IN THIS CHAPTER

- » Checking to see if the generation-skipping transfer tax applies to you
- » Understanding the generations
- » Examining generation-skipping transfer tax rates
- » Getting technical with generation-skipping transfers and the corresponding tax

Chapter 12

Skipping around the Generation-Skipping Transfer Tax

The generation-skipping transfer tax (GSTT) is the most complex estate-related tax you'll come across and the most difficult to understand. Congress introduced the GSTT as a way to prevent well-to-do families from sheltering large amounts of wealth from federal estate taxes by skipping a generation within a family and giving gifts, setting up trusts, or leaving large amounts of money to "lower" generations within a family (grandchildren instead of children, for example).

The good news is that, most likely, the GSTT won't apply to you (we explain why in this chapter). But you still should understand the basics of the GSTT so you won't stumble into a "tax trap" by thinking you're cleverly avoiding down-the-road estate taxes if you transfer large amounts of money to your grandchildren instead of your children. Instead of being one step ahead of the IRS, you may only wind up leaving behind a large headache — and a large GSTT bill — for everyone instead!

The Generation-Skipping Transfer Tax: A Parable

Imagine your name is Rockefeller Vanderbilt Carnegie (your friends call you "Rocky One"), and you're by far the wealthiest person in your town of Hard Coal, Pennsylvania. You're now 75 years old, but many years ago you began your career as a coal baron. You retired from the mining business, and now your only son, Rockefeller Vanderbilt Carnegie II ("Rocky Two"), runs the family business, and he's been so successful that he's the second wealthiest person in Hard Coal.

Both you and Rocky Two have the same "problem" from the standpoint of estate planning and estate taxes: too much money! More specifically, you're both worried about the tax bite on your estate when you die and you leave most of your estate to Rocky Two, and what will happen when Rocky Two dies and tries to pass his estate on to his two children: his son, Rockefeller Vanderbilt Carnegie III ("Rocky Three"), and his daughter, Adrian.

You both worry about the inevitable "double taxation" of a significant portion of your estate that eventually will make its way to Rocky Three and Adrian. When you die, you'll face a pretty big estate tax bill, even though you've been using gift giving (see Chapter 11), will substitutes (see Chapter 6), trusts (see Chapters 7–9), and other estate-planning strategies to reduce the amount of your taxable estate. Regardless, you expect estate taxes to be significant.

But because Rocky Two's estate is worth so much, whatever he gets from your estate after *you* die will most likely be subject to estate taxes *again* after *he* dies and leaves much of his estate to Rocky Three and Adrian. Basically, property that you pass to the next generation in your family (Rocky Two) that he in turn passes on to the next generation (Rocky Three and Adrian) gets taxed each time that property gets passed down. And when Rocky Three and Adrian pass their respective property on to their children, yet another tax hit will happen, and more of what started off as your estate will disappear into the clutches of the taxman. (As Rocky Three puts it, "Yo, Adrian! All this tax packs quite a punch!")

So, Rocky Two, always the clear-thinking businessman, comes to you and says, "You know what, Dad, I have lots of my own money. Why don't you just leave whatever you were going to set aside for me in your will to Rocky Three and Adrian instead of me? I'm just going to leave that property to them anyway. This way, the property will only be taxed once."

You think Rocky Two's plan is a pretty good idea to save on taxes, but guess who else thinks Rocky Two is onto something? The federal tax guys! And because the tax guys get to make the rules of this game (helped by the U.S. Congress, who actually creates the laws), they came up with a "special tax" called the GSTT to counteract and negate the "skipping over" of one generation in a family and passing property to yet another generation to try to save on estate taxes.

Taking Comfort from the Exemption

Your first step in dealing with the GSTT is seeing if you can sneak through the escape clause — figuring out if your estate is exempt. And on this front, we have good news: Your estate probably is.

In fact, if you read through this section and decide that, based on your financial situation, you see no chance that the GSTT will ever apply to you, you may want to just skip over (pun intended) the rest of this chapter. After all, if you later become very wealthy and have to then worry about generation-skipping transfers and the tax impact, you can always come back to the rest of our GSTT discussion.

As with the gift and federal estate taxes (see Chapters 11 and 13), the GSTT has an *exemption amount* that you can think of as a magic number for tax-saving purposes. Under the 2001 tax law, you have a lifetime exemption for generation-skipping transfers under a specified dollar amount — basically, a free pass up to a certain amount of generation-skipping transfers without having to worry about the GSTT.

And, as with the federal estate tax, the amount of the lifetime exemption amount actually increases each year based upon a percentage tied to annual inflation. The tax applies only to transfers over the exemption amount ($12,920,000 per person or $25,840,000 for a married couple in 2023). We can only hope that we are all so lucky as to have to worry about this tax!

The exemption amount can be applied to any combination of lifetime generation-skipping gifts and generation-skipping transfers at death. As a result, you can use a mix-and-match approach to direct transfers (that is, gifts) while you're alive and what you leave behind through trusts after you die.

TIP

The GSTT lifetime exemption amounts apply to each person, which means that if you're married, you and your spouse have twice as much to work with for generation-skipping property transfers.

TIP

Most gifts exempt from gift tax are also exempt from generation-skipping transfer taxes; you don't need to count those amounts against your GSTT exemption.

Playing Hopscotch: Understanding Generation-Skipping Transfers

You need to understand how the GSTT works and what you can do to minimize its effects if you plan on making generation-skipping transfers. We assume you know how to reduce your taxable estate by gift giving (see Chapter 11), will substitutes (see Chapter 6), and trusts (see Chapters 7–9). Though all the details of the GSTT can get very complicated, its most basic aspects are fairly easy to understand. Typically, the GSTT can come into play in three kinds of situations:

- **You directly transfer property to someone and in doing so, you skip at least one generation (we explain what we mean in a moment).** The most common kind of direct property transfer that fits this category is to transfer property to your grandchildren or great-grandchildren (or, on the flip side, if you were to receive property directly from one of your own grandparents or great-grandparents).
- **You establish a trust for your child's lifetime, with the remainder of that trust going to your grandchildren after your child dies.**
- **You place property in trust to benefit someone and, in doing so, you also skip at least one generation.** Again, a common generation-skipping trust situation is when you create a trust to benefit your grandchildren, great-grandchildren, or both.

So, no matter whether you transfer property directly to someone or do so through a trust, certain rules come into play to determine if you're skipping generations and, therefore, need to worry about the GSTT.

Knowing the rules for skipping generations (so you don't break 'em)

A *generation-skipping transfer* occurs — and your potential exposure to the GSTT begins — when:

- You transfer property to someone two or more generations lower than your own.
- You transfer property to someone more than 37½ years younger than you.

OUR REGULAR DOSE OF LEGAL-SPEAK

In Chapter 6, we discuss the pattern in legal terminology where words ending in *–or* are the persons controlling the property whereas words ending in *–ee* are the persons receiving something from the *–or.* With generation-skipping transfer tax lingo, the same holds true. The *transferor* transfers the property to the *transferee.*

Generation-skipping transfers typically occur within families, so according to the first rule — two or more generations lower than your own — the following are common examples of generation-skipping transfers:

- You transfer property to your grandchild.
- You transfer property to your great-grandchild.
- You transfer property to your sister's grandchild (your great-grand-niece).

TIP

Imagine any family tree — perhaps your own family's — and think about how you have some old-timers (maybe the family's great-great-grandparents, who first came to the United States many years ago) at the top of the chart, their children one level below them, their children's children below them, and so on. Any time you move down the family tree at least two levels between any two people, you're skipping a generation.

Generation-skipping transfers can also occur outside of your family! The second rule — someone more than 37½ years younger than you — comes into play if, for example, you transfer property to your lifelong best friend's oldest daughter. If you're 45 years old and you transfer money to your best friend's oldest daughter, who is 6 years old, you made a generation-skipping transfer.

Clarifying the generations and confusing complications

TECHNICAL STUFF

Figuring out who is in which generation within your family is usually straightforward. However, be aware of two minor considerations:

- **The same-generation treatment for spouses and former spouses, regardless of the age difference:** If you transfer property to a spouse — or even your ex-spouse — even if they're 37½ years older or younger than you, the transfer isn't considered to be generation skipping.

- **The *deceased ancestor skip rule* when you skip up a generation:** This rule allows *transferees* (people receiving property) to move up (or skip up) a generation and avoid a generation-skipping transfer. The rules are as follows:
  - You and the other person must be blood relatives, not related by marriage (so stepfamily members do not count).
  - The *transferee* (again, the person receiving property) must be a *lineal descendant* of the *transferor* (the person giving the property). Lineal descendants are family members in a vertical line on a family tree like children, grandchildren, great-grandchildren, and so on. (A more common, but less official term, is *direct descendant.*)
  - The transferee's parent must be dead at the time of the property transfer.

  For example, if in your elderly years, you transfer property to a grandchild, your transfer is usually considered generation skipping. However, if your grandchild's parent (your own child) has already died, then the transfer isn't considered to be generation skipping. Why? Because of your child's death, your grandchild has moved up (or, again, skipped up) one generation and for estate transfer purposes, now is considered in the same manner that your child once was, only one generation removed from you.

Making Sense of GSTT Rates

When you use up your lifetime exemption amount, you need to worry about the GSTT. At 40 percent, the GSTT rate is among the highest tax rates in the United States — and a huge tax bill if you didn't find an exemption mentioned earlier.

WARNING

As we note earlier in this chapter, GSTT can come into play either while you're alive through property transfers as gifts or at your death through your estate's property transfers. Keep this very important point in mind: Your property transfers may be subject to the GSTT in addition to any gift tax or estate tax that you owe! You can't offset the GSTT against your unified credit (see Chapters 10, 11, and 13) as you can the gift tax and estate tax. So, whereas the payment of a gift tax or estate tax may actually offset against your allowable unified credit, you actually have to pay the GSTT, if due.

Looking Deeper into Generation-Skipping Transfers and the GSTT

Don't say we didn't warn you! Generation-skipping transfers and the GSTT are among the most complex estate-planning subjects. As we note earlier, if you don't see yourself giving millions of dollars to your grandchildren or setting up multimillion-dollar trusts to benefit your great-grandchildren, you may just want to quickly skim or even skip the rest of this chapter.

To understand the GSTT, you need to look at:

- Different types of skips — direct or indirect
- The impact of the skip type on your potential tax liability
- The importance of the skip valuation date for different types of skips

Scanning over the skip types

The word *skip* sometimes brings back carefree memories of summer days in childhood, but in the world of the GSTT, the word *skip* is anything but carefree. In fact, different types of skips have very different tax impacts.

TECHNICAL STUFF

You need to make a distinction between two different types of people: the *skip person* and the *nonskip person.* If a *transferee* (the person receiving property) is two or more generations removed from the *transferor* (the person transferring property), the transferee is called a *skip person.* For example, your oldest grandchild is a skip person in relation to you because they're two generations removed from you. However, your oldest daughter, who is your oldest grandchild's mother, is called a *nonskip person* because she's only one generation removed.

Based on the distinctions between skip persons and nonskip persons, you have two types of skips to look at:

- Direct skips
- Indirect skips

Before proceeding, we want to answer the question you're about to ask: Why do I need to understand skips? The answer is that skips have to do with money:

- When the GSTT is reported and owed
- How the GSTT is calculated

Direct skips

TECHNICAL STUFF

A generation-skipping transfer is considered to be a *direct skip* if the property transfer's interest is only with a skip person. Think of a direct skip as a transfer that totally bypasses the middle generation (the nonskip person) and goes directly to a skip person who is two or more generations removed. For example:

- Your grandmother gives your brother and you $25,000 each.
- Your great-grandfather names your father as the sole beneficiary of an irrevocable trust.

In these simple examples, the only people with an interest in the property after the transfer are skip persons — those who are two or more generations lower than the transferor — which means that these generation-skipping transfers are considered direct skips.

Indirect skips

TECHNICAL STUFF

An *indirect skip* is a generation-skipping transfer where both a skip person and a nonskip person hold interest in the transferred property. With indirect skips, the property transfer doesn't go directly to a skip person because a nonskip person is also involved in the transfer. For example:

- Your grandmother sets up a $300,000 irrevocable trust with income paid to your father for his lifetime and the remainder paid to your brother and you at your father's death.
- Your great-uncle, who is close to your brother, places his beach house in a *life estate* for your mother with a *remainder interest* in the beach house to your brother, meaning that your brother receives the house upon your mother's death.

In the first example, your father is a nonskip person (one generation removed from his own mother) and your brother and you are both skip persons (two generations removed from your grandmother, who is the transferor). In the second example, your mother is a nonskip person and your brother is a skip person. Because these two examples of generation-skipping transfers involve both skip and nonskip persons, the transfers are indirect skips.

TECHNICAL STUFF

For direct skips, the rules that affect the "when" and "how" are fairly straightforward. GSTT is reported and owed depending on whether the transfer occurred during the transferor's lifetime or at that person's death. The party filing the gift tax return pays any tax and reports it by April 15 of the year following the transfer.

Direct skips made at the transferor's death are reported and paid with the estate tax return, which is due nine months after the date of death.

If the applicable dates we describe look familiar, you may recognize them as the same dates for the gift tax return, as we discuss in Chapter 11. Coincidence? Not really. The form required for a generation-skipping transfer is the same Form 709 as the federal gift tax return form.

The person who files the estate tax return — such as the personal representative — is also responsible for reporting the direct generation-skipping transfer and paying any associated GSTT due.

TECHNICAL STUFF

For indirect skips, the reporting requirements aren't as well defined as they are for direct skips. Why? Because with an indirect skip, both skip persons and non-skip persons have an interest in the property transferred: Part of the property goes to the nonskip person and part of the property goes to the skip person. Because only the part of the property transfer that goes to the skip person is subject to the GSTT, the tax can't be determined right away.

IN THIS CHAPTER

- » Grasping the federal estate tax basics
- » Doing the appropriate federal estate tax calculations
- » Figuring out how and when to pay federal estate taxes
- » "Stepping up" the tax basis of your property after you're gone

Chapter 13

Paying or Not Paying the Death Tax: That's the Question

You know Ben Franklin's saying: "The only two certainties in life are death and taxes." Today, those two items come together in the federal estate tax.

At the most basic level, the federal estate tax is fairly simple: You add up your estate's total value when you die (actually, someone else does the tallying, considering you're dead) and subtract out certain exclusions. If the remaining value is greater than a particular amount, your estate owes a percentage of that remaining value for federal estate taxes.

But don't worry — most people can escape the federal estate tax by planning right. In this chapter, we tell you how.

Discovering Federal Estate Tax Basics

You can understand the federal estate tax by focusing your attention on four main items:

- What the federal estate tax is and when it comes into play
- The exemption amount magic number and why you may not ever have to worry about federal estate taxes
- The estate tax bracket rates — specifically, the top rates
- The complications of the moving target situation between now and 2026

We discuss each of the preceding topics in the following sections.

Figuring out how the federal estate tax works

The simplest straight-to-the-point definition of the federal estate tax is this:

> A tax on the transfer of property from your estate to others

Basically, if you own something today and somebody else owns it after you die, the federal estate tax comes into play for that transfer of ownership.

TECHNICAL STUFF

Don't panic, though! Even though the federal estate tax technically applies to every single transfer of ownership, your estate may not actually owe any taxes. The potential tax depends on your estate's total value and how that total compares to how much the government allows you to transfer without taxing it. This is known as the *exemption amount* (see the next section).

As we discuss in Chapters 10 and 11, the federal estate tax is part of a unified tax system along with the gift tax. Essentially, between the gift tax and the federal estate tax, everything you own is at least considered for taxation when you transfer ownership, either while you're alive or after you die. "Everything you own" includes property that:

- Is mentioned in your will (see Chapter 3)
- Is covered by a *will substitute,* such as joint tenancy or a living trust (see Chapter 6)
- Is covered by your state's *intestate laws* if you don't have a completely valid will and, therefore, die either intestate or partially intestate (see Chapter 3)

WARNING

When we say the federal estate tax applies to everything you own at the time of your death, we mean everything! So, don't think that if you leave something out of your will (or if you don't even have a will) the estate tax won't catch up with you. As we discuss later in this chapter about how to calculate your estate's value for tax purposes, completeness is the name of the game.

Using your exemption to sidestep the government

The sort-of-good news about federal estate taxes that we briefly mention in the previous section is that even though everything you own is subject to the tax, the federal estate tax comes with a built-in magic number — more formally, an *exemption amount.* If your estate's total value is below the exemption amount, your estate doesn't owe any taxes. Most people don't need to worry about federal estate taxes because the exemption amount is so high right now.

Because of the unified system of gift and estate tax we mention earlier, the exemption amount magic number actually applies to the total value of property you gave away in the form of gifts prior to death, as well as property you leave to others upon your death.

For 2023, the exemption amount is nearly $13 million, increasing each year by the rate of inflation until 2026 (unless Congress and the president change the current law). If you already have an estate plan in place that was done prior to 2017, the exemption amount went up a lot in 2017 when Congress passed — and the president signed — the Tax Cuts and Jobs Act of 2017.

WARNING

When looking up tax law tables on the Internet, make sure you're looking at current information from the 2017 tax law and not old numbers. Use Table 13-1 for current figures.

TABLE 13-1 **Federal Estate Tax Exemption Amounts, 2022–2023 (2017 Tax Law)**

Year	Exemption Amount
2022	$12.06 million
2023	$12.9 million

What do the amounts in Table 13-1 mean? If you were to die in 2023, up to $12.9 million of your otherwise taxable estate (we discuss the applicable calculations in "Digging Down to the Bottom Line," later in this chapter) is free of federal estate taxes upon your death. (For ease of understanding, assume you haven't previously given any taxable gifts that have been applied against your unified credit, as we discuss in Chapter 11.) If your taxable estate is $12.9 million or less, then congratulations (sort of, considering we're talking about your death) — your estate doesn't owe any taxes.

What if you die in 2023, and the value of your taxable estate is $13 million? Basically, you subtract the magic number of $12.9 million, which leaves $100,000 subject to estate taxes. Simple enough, right?

But suppose you die in 2024 or 2025 rather than 2023, and the value of your taxable estate is still $13 million, or substantially more, provided that your real estate empire or investment portfolio outperformed and grew in value. Now, your estate doesn't owe any federal estate taxes, because the exemption amount (again, think of the exemption amount as a magic number) is $13 million, the same as your taxable estate's value, which means your entire estate can be transferred to others free of federal estate taxes.

TECHNICAL STUFF

The IRS adjusts the exemption amount annually and usually announces the new amount in the autumn of the previous year. So, the 2024 exemption amount should be available in the fall of 2023, and the 2025 exemption amount in the fall of 2024.

One of the biggest "unknowns" for federal estate taxes is what may or may not happen between now and 2026 when the current law sunsets and the amount of the exemption may be cut or even increased. Remember that this assumes that Congress and the president don't change anything between now and then. The tax may still be there, but the amount of your assets that may be taxed could be a lot more because the amount exempted from the tax will be much lower.

Looking at the highest federal estate rates

The first thing that you need to understand is that, just like with your income taxes, the federal estate tax is actually constructed from a series of *brackets* (amounts) with a steadily increasing applicable tax rate. Under the 2017 tax law, the tax rates start at 18 percent and increase to 40 percent, depending on the total value of your estate.

TIP

Instead of including the entire schedule of federal estate tax brackets and applicable tax rates — specifically because the top rate moves frequently — we suggest you get the latest and greatest information from a reputable source, such as your tax accountant or the Internal Revenue Service (`www.irs.gov`).

In 2022, the top rate was 40 percent on estates valued over $12.06 million. By comparison, the old top tax rate before the 2017 changes was 55 percent. (Remember that number — we come back to it in a moment.) The bottom line is that if your estate is worth more than $12.06 million, you'll need to plan for the federal estate tax unless you're a firm believer that the government will be willing to give up such a large amount of revenue by repealing the tax (in 2023, estate taxes are projected to generate over $3 billion for the government).

TABLE 13-2 Federal Estate Tax Top Rate, 2022

Taxable Amount	Estate Tax Rate	What You Pay
$1–$10,000	18%	$0 base tax 18% on taxable amount
$10,001–$20,000	20%	$1,800 base tax 20% on taxable amount
$20,001–$40,000	22%	$3,800 base tax 22% on taxable amount
$40,001–$60,000	24%	$8,200 base tax 24% on taxable amount
$60,001–$80,000	26%	$13,000 base tax 26% on taxable amount
$80,001–$100,000	28%	$18,200 base tax 28% on taxable amount
$100,001–$150,000	30%	$23,800 base tax 30% on taxable amount
$150,001–$250,000	32%	$38,800 base tax 32% on taxable amount
$250,001–$500,000	34%	$70,800 base tax 34% on taxable amount
$500,001–$750,000	37%	$155,800 base tax 37% on taxable amount
$750,001–$1 million	39%	$248,300 base tax 39% on taxable amount
More than $1 million	40%	$345,800 base tax 40% on taxable amount

With the highest tax rate, each year through 2026 increasingly less of your estate is likely to be lost to federal estate taxes, and then in 2026 everything changes yet again, either because the 2017 tax law changes expire automatically or due to new tax laws that will be enacted.

Tracking a moving target

Nobody really knows what will happen to the federal estate tax in 2026. So what can you do in this climate of tremendous uncertainty?

TIP

If your estate is large enough now or if you expect your estate to be large enough by the time of your death— work with your accountant, your attorney, and the other members of your estate-planning team to develop a prudent and reasonable strategy to keep as much of your estate as possible safe from taxes. (See Chapter 14 for details on how to plan to minimize the bite the federal estate tax takes on your estate.)

Develop a prudent plan with your estate-planning advisers that includes a variety of trusts and other tax-advantaged investment vehicles and the pointers we present in Chapter 14.

Digging Down to the Bottom Line

You probably aren't surprised to discover that you can determine your taxable estate's value — that is, the bottom line of your estate after all allowable deductions are included — in several different ways to then tell if you owe any federal estate taxes and, if so, how much.

In this section, we help you through this maze by showing you the shortcut — the most basic steps that apply to most people's estates. Where applicable, we provide you with additional information for which you may want to work with your estate-planning team.

TECHNICAL STUFF

To be as precise as possible, though, the official formula for calculating estate taxes is as follows:

(Gross Estate – Deductions) = Net Estate + Taxable Post-1976 Lifetime Gift Transfers = Taxable Estate × Applicable Estate Tax Rate = Tentative Estate Tax – Credits = Estate Tax Due

Wow! The good news, though, is that to get an good idea of the potential tax bite, you may very well need to:

- Figure out the value of your *gross estate.*
- Calculate deductions from your gross estate to arrive at your *net estate.*
- Compare the result with the exemption amount magic number to see if you owe any estate taxes and, if so, how much.

In the following sections, we walk you through all three of these steps.

Figuring out your gross estate's value

When figuring out your estate's value for estate tax purposes, you need to know all your stuff's exact value! For purposes of the estate tax calculations, your starting point is your *gross estate,* which for most people includes the following:

- Your probate estate (as we discuss in Chapter 5) — everything that passes through probate
- Your ownership share(s) of property held in some form of will substitute (see Chapter 6), such as joint tenancy with right of survivorship
- Your life insurance's value, depending on certain factors (see Chapter 17)

Regardless of whether you're dealing with probate or nonprobate property, you need to include your ownership percentage of each item of property. For example, your one-third-ownership share of a real estate investment that you and two other people own needs to be included. However, when dealing with partial ownership, you come across various rules that apply depending on

- The form of ownership
- Your contributions relative to other co-owners

Instead of going through all the various combinations, we suggest that you work with your attorney and accountant to make sure that you correctly value your ownership portions of any jointly owned property (including property you own with your spouse) so you're neither overcounting nor undercounting your estate's value.

THE DOWNSIDE OF WINNING THE LOTTERY

Remember the last time you heard that someone won $60 million in the lottery? Besides being a tad envious, did you think they were free from financial worries? They may be set for life, but their estate may face some major taxation if they don't take immediate action.

When determining your estate's value, you may need to know about *deferred income,* or income that technically isn't owned (that is, shows up in a bank account) upon death but rather is guaranteed to be received in the future.

Perhaps the most stunning example: Instead of choosing to receive a lump-sum payment, the person who won the lottery elects to receive a larger amount paid out over an extended period of time, such as 20 or 25 years. (When most state lotteries began in the 1980s, few if any had a lump-sum option, forcing winners to accept the extended annuity option).

Guess what? If you were to win tens of millions of dollars in the lottery and elect an annuity option and then were to die a year or two after your lucky winning day, your estate would get whacked by federal estate taxes, because the value of your lottery winnings would be included in your estate, even though your estate won't receive most of the money for years!

Technically, a lower number represents the present value of the annuity stream and not the entire "face value" of your annuity winnings — say, $2 million each year for 18 more years after you die, or a total of $36 million. Anyone who has taken a college finance class is familiar with present value calculations, which use a discount rate to figure out what that annuity stream is worth today. For the sake of simplicity, all you need to realize is that even using present value calculations, your estate is still taxed on assets that technically aren't even part of the estate because money hasn't yet been received.

Other examples of *income in respect of a decedent* (the technical term) include certain bonuses to be paid in future years, deferred compensation, and royalties. If any of these situations apply to you and your estate, work with your estate-planning team to develop a strategy to pay any estate taxes. For example, you may decide to purchase a life insurance policy that covers the estate taxes if you die before the entire stream of future income is received.

PICKING A DATE TO VALUE ALL YOUR STUFF

Within the world of estate taxes, your property is valued at its *fair market value.* As we discuss in Chapters 1 and 2, fair market value is essentially the value that a willing buyer and seller determine is the value in the market.

Your property is valued on the date of your death. However, another date, which is called the *alternative valuation date,* can also be used to determine the date that fair market value is set. Specifically, the alternative valuation date is six months after the date of your death. So, why two different dates to choose from for determining fair market value?

If property decreases in value between the date of death and the alternative valuation date, choosing the latter may result in a lower value of the gross estate due to a decrease in the fair market value and, thus, lower estate taxes. Basically, if your property's value decreases dramatically shortly after you die, why should your estate have to pay significantly higher taxes on out-of-date valuations, essentially taking that money away from your beneficiaries? (Think "stock market, post-2000.")

However, you (or, more accurately, your personal representative) can't pick different valuation dates for different property within your estate. Basically, when you select to use the alternative valuation date, all property in the gross estate must use this same date.

Calculating deductions from your gross estate

As we note in Chapter 1, when it comes to federal estate taxes and your estate's value, more is definitely not better! Sure, you may have a few moments of satisfaction when you add up your property's value and realize that you're actually worth much more than you thought, but when you realize that estate taxes can grab a pretty hefty bite out of your estate, you may think differently.

The good news: You have several deductions to work with to reduce your estate's value before making any tax calculations. Essentially, you use these deductions to reduce your gross estate and determine your *net estate.*

Just as with your federal income taxes, you want to use deductions to the greatest extent possible to come up with the lowest possible net number no matter how high your starting gross number was. So, whether you're dealing with gross income or gross estate, and net income or net estate, your strategy is the same: Maximize those deductions!

For most people, the main deductions for estate taxes are

- The marital deduction
- The charitable deduction
- Deductions for debts on your property
- Cost-of-dying deductions (far less than either marital or charitable deductions, unless you're planning on one heck of an expensive funeral)

The marital deduction

You can use the marital deduction to shelter every single dollar of your estate from taxes — no matter how much your estate is worth, and no matter what the exemption amount magic number is in the year you die — by simply leaving everything you own to your spouse.

Or, if you want, you can leave part of your estate to your spouse and other portions of your estate to your children or others; whatever you leave to your spouse is free of estate taxes.

TECHNICAL STUFF

The marital deduction applies to any property, no matter what form of ownership applies: community property, joint tenancy with right of survivorship, and so on. However, the marital deduction applies only if your spouse is a U.S. citizen! (If you're married to a non-U.S. citizen, check with your accountant and attorney about special rules governing gifts, as well as special trusts you can use, to shelter property transfers from some gift and estate taxes, at least for a while.) However, if you aren't a U.S. citizen and your spouse is, your spouse is eligible for the marital deduction. Again, if the marital deduction applies to you, work with your accountant and attorney to figure out the best plan.

The marital deduction applies only to legally married couples (same-sex couples *and* opposite-sex couples). Unmarried couples, regardless of any state domestic partner statutes, aren't eligible for the marital deduction from federal estate taxes (just as with being able to claim "married" status when filing federal income taxes).

So, you've found the perfect way to beat Uncle Sam: Just leave everything to your spouse, and you have no estate tax worries, right?

WARNING

Not so fast! Depending on your financial situation and that of your spouse, you may be better off not taking advantage of the marital deduction! Basically, you and your spouse may benefit more by dividing up the property you've accumulated over the years more or less evenly, with each of you trying to stay beneath the exemption amount magic number for your respective property.

By not leaving your respective estates to each other (and, therefore, taking advantage of the marital deduction), you can still avoid federal estate taxes — assuming that you've each stayed beneath the exemption amount — by leaving your respective estates to other people (for example, divided among your children).

TECHNICAL STUFF

The marital deduction allows the transfer of estate property up to the then-current exemption to pass free of federal estate tax essentially deferring the tax until the surviving spouse dies. When the surviving spouse dies, the estate will be subject to the then-current federal estate tax law.

WARNING

The preceding example is based solely on tax considerations for families with a reasonably large amount of assets and may very well not be the best strategy for you! For example, if you and your spouse both have modest incomes and modest estates with a combined value well beneath even the lowest exemption amount of $1 million, then you really don't have to worry about pursuing a strategy to avoid federal estate taxes, because those taxes will likely never apply to you. In fact, if you die first and you don't leave your property to your spouse (and technically take advantage of the marital deduction, even though doing so isn't really necessary because no estate taxes would be due anyway), you may cause problems for your family if your property isn't available to your spouse to use or sell. Don't try to be clever and end up causing problems for your family by trying to avoid taxes that you wouldn't have to pay anyway!

The charitable deduction

In Chapter 11, we discuss how gifts to qualified charities are exempt from gift taxes. The same is true for property you leave behind after you die that is designated to go to a qualified charity.

Depending on your situation — married or not, children or none, family well off on their own or not, and so on — you may want to consider leaving some or all of your very valuable, in-the-estate-tax-zone estate to one or more charities. After all, if you decide that your estate isn't going to go to your family because they don't need it (or if you have no family for your estate to go to), why not leave your property to your favorite charity or charities via the charitable deduction rather than the government through estate taxes?

Deducting debts

If you have a home worth $1 million, your gross estate reflects that complete value. However, suppose you still owe a mortgage of $700,000? Why should your estate pay taxes on the complete value of your home when you technically own only $300,000 of that property?

You get to deduct all debts — such as mortgages, credit card debts, personal loans, and everything else that we discuss in Chapters 1 and 2 — as negative balance amounts in determining your estate's value. So, essentially, the calculations work out correctly: Your net estate factors out your debts from what you own.

Deducting the cost of dying

The costs of your funeral and expenses to your estate, such as probate fees and appraisal fees, are also deductible from your gross estate before arriving at a bottom line number upon which to figure out taxes due (if any). Make sure that your personal representative works with your accountant or attorney (or better yet, lets one of those professionals fill out the estate tax return) to take advantage of permissible costs in the year in which you die.

Going for extra credit

After you add up all your property and then reduce your property's value as much as you can, you figure out what (if any) tax liability your estate has. Part of the what-do-you-owe calculations includes applying certain credits, such as foreign estate tax credits or out-of-pocket gift tax credits, against the number you come up with.

TIP

However, because estate tax credits get complicated and are a moving target as a result of tax law changes, we recommend consulting with your accountant and attorney.

Choosing How to Pay Estate Taxes

In Chapter 3, we mention how you can choose to include a *tax clause* in your will that specifically identifies the manner in which any estate taxes are paid (for example, from a specific bank account or from the proceeds of selling a particular portion of real estate). Alternatively, you can use the default approach, which is having any estate taxes paid out of property covered by your will's residuary clause.

Whichever approach you choose, you need to periodically make sure that your selected means of paying estate taxes is still aligned with your estate's status. For example, if you've specifically designated the proceeds from the sale of stock or real estate to be used, make sure that the equation still works. Double-check that the proceeds are adequate to cover anticipated estate taxes and that your estate's overall value has neither increased nor decreased too much.

Or, if you're going to rely on a residuary clause, make sure that the value of property covered by the residuary clause is still adequate to cover taxes. You also don't want any of your beneficiaries that you're taking care of through residuary property to be shortchanged if most or all of your residue is needed for a larger amount of taxes than you had anticipated.

Filing the Estate Tax Return

The federal estate tax return on Form 706 is due within nine months of the death date, unless an extension has been granted. Six-month extensions are available provided the request is made prior to the due date of the return and if the estimated (correct) amount of tax is paid prior to that due date.

WARNING

Many personal representatives decide to file the estate tax return along with the final income tax return, but if you were to die between April 15 and July 15, then your estate tax return needs to be filed prior to your final income tax return the following April 15 to meet the nine-month deadline.

If your *gross estate* exceeds the exemption amount in the year you die, your personal representative must file an estate tax return, even if after taking all permissible deductions, your net estate falls below the tax radar and no tax is due.

WARNING

One of the responsibilities of your personal representative is to file your estate tax return in a timely manner (see Chapter 5). However, your beneficiaries may be liable for estate taxes where they've received property and the estate tax hasn't been paid.

Stepping Up to the Plate and Filling the Bases (Basis)

In Chapter 14, we discuss various "give-and-take" decisions you need to make when managing your estate's tax considerations. In this section, we discuss one of those items — adjustments to the basis of property you transfer to others upon your death.

According to tax law, property has a *basis* that is (to oversimplify a bit) calculated as the cost of the property plus improvements you make. Think about the calculations you make when selling your home or figuring out what the gain (or loss) on rental real estate you own will be. You start with your purchase price, and then add in the cost of that new kitchen and how much that new roof cost you. So, if you bought a rental property for $100,000 and put another $35,000 worth of improvements into the house, your basis is $135,000. Later, if you sell that property for $200,000, your gain is $65,000 ($200,000 minus your $135,000 basis).

Suppose, though, that you never sell that rental property, and when you die, the house is worth the same $200,000 that we mention earlier. And suppose you leave that house to your sister in your will. Under current tax law, your sister's basis in this property that she now owns isn't the same $135,000 that yours was, but rather $200,000 — the house's current fair market value.

When property is passed to someone else through inheritance, the basis is *stepped up* to the current fair market value, which eventually saves the property's recipient (your sister, in this example) money on taxes. Suppose five years later your sister sells the house for $235,000. Her taxable gain will be $35,000 ($235,000 minus her $200,000 stepped-up basis), which is far better than a taxable gain of $100,000 ($235,000 minus what your basis had been — $135,000). Your sister still gets the same amount of money from the sale of the rental house; she just owes much less in taxes.

TECHNICAL STUFF

So, what does stepping up the basis of property have to do with your (or anyone else's) estate taxes? Technically nothing, because your property is still valued as part of your gross estate according to its fair market value. However, as part of your overall estate planning, you need to be aware of a very important distinction. The basis of property isn't stepped up when you give the property to someone as a gift while you're still alive, compared to the stepped-up basis for inherited property. So, even though gift taxes and estate taxes are part of the same unified system, post-transfer rules regarding whether the basis of property is adjusted can make a big difference in eventual taxes to your beneficiaries.

IN THIS CHAPTER

» **Assessing your current financial picture and potential tax liability**

» **Looking ahead to understand your possible future tax liability**

» **Deciding on your estate-planning strategy**

» **Putting together a comprehensive estate-related tax plan**

Chapter 14
Planning to Minimize All Your Estate-Related Taxes

If you enjoy games and puzzles like chess and the good old Rubik's Cube, then you may feel at home when it comes to planning for estate-related taxes. But if you always lose at chess and were never able to solve a Rubik's Cube, and if you prefer a jigsaw puzzle that comes with a label that states "suitable for ages 5 and up," then don't worry, we've boiled down the steps you need to take for estate-related tax planning into a concise, comprehensive action plan.

Notice that in this chapter we use the term *estate-related taxes,* and not *estate tax, federal estate tax,* or even the slang term *death tax.* Just as you do when you play your annual income tax fun and games, you likely find yourself dealing with more than one type of tax (for example, taxes on capital gains and self-employment income). In addition, you run into the federal, state, and local income tax. As a result, when dealing with estate planning, you need to think about *estate-related taxes,* not just the federal estate tax. These include both federal and state estate taxes.

In this chapter, we help you to focus on the estate-related taxes that will most likely impact your estate — and to not worry about taxes that don't.

TECHNICAL STUFF

Be careful as you read the words *federal* and *state.* Some of the taxes apply everywhere, while some states have their own estate tax or even another tax known as *inheritance tax* (paid by your beneficiaries rather than your estate) that you may need to plan for accordingly.

Figuring Out Where You Are Today

Your first step in minimizing your estate-related taxes is to conduct a snapshot analysis of your current situation. Ask yourself: "Would I have any estate-related tax liability if I died today?"

In order to determine your estate-related tax liability, you need to perform the following activities:

1. **Determine your estate's value (as discussed in Chapter 2).**
2. **Conduct an inventory of what estate-planning steps you've already taken.**
3. **Consult the appropriate tables and charts to understand preliminary federal and state tax liability.**
4. **Look for tax traps that may unnecessarily cost you money.**

After completing the preceding list of activities (we show you how in this section), you have a good idea of which of the following categories you fall into with regard to estate-related taxes:

- **Significant tax-related concerns,** which means you have a lot of work to do with your estate-planning team
- **Modest tax-related concerns,** meaning you have some exposure, but with some fairly simple tactics, you can minimize your estate-related tax liability — or perhaps make that liability disappear altogether
- **No tax-related concerns,** meaning your estate's value is so far below the tax radar and you live in a state without any estate or inheritance taxes, that you don't need to worry at all about estate-related taxes

Determining your estate's value

In Chapter 2, we described how you need to have a good idea of your estate's value, and the tasks and steps you need to assess that value. In other chapters, such as Chapter 15 on family businesses, we further discuss ways you can determine your estate's value.

So, if you haven't completed this estate valuation activity, get to it! In this section, purely for example, we assume that your estate right now is worth $15,000,000 after subtracting out liabilities such as the remaining mortgage on your home, an automobile loan, and credit card debt.

Totaling your gifts to date

In Chapter 11, we discuss how the federal estate tax and gift tax are part of a unified tax system. In that system, you have a set of magic numbers that you can use in a mix-and-match manner to transfer property from your estate to others — which is what you're planning for, right? Beyond nontaxable gifts, such as those with amounts lower than the annual exclusion amount or that are otherwise free of gift tax (see Chapter 11 for the details), your taxable gifts reduce the amount of property that you can leave to others free of federal estate taxes after you die.

You need to compile a comprehensive list of any gift giving, as well as the tax impact of those gifts. Take that amount and set it aside (you use it in the next section). Also, write down your estate's value. You use the two figures to get an idea of estate-related tax liability if you were to die today.

For example, suppose you're generous and you've given $1,000,000 worth of taxable gifts through the years, and you haven't paid gift taxes along the way because you gave gifts each year up to the allowable maximum we discuss in Chapter 11. Instead of paying the gift taxes, you filed your gift tax returns as required and you're holding off on paying gift taxes until those amounts are settled up along with federal estate taxes after you die — we show you how this works in a little while.

Checking the tax tables

Take a look at the various tables for estate-related taxes — particularly Table 13-1 in Chapter 13 — and assume that you were to die today. You want to compare the exemption amount magic numbers for this year (that is, the year in which you're doing your estate-related tax planning) with the remaining amount of your exclusion, based on the value of your estate minus gifts that still need to be settled up.

TIP

Make sure you use official tax table sources, such as those available on the IRS website (`www.irs.gov`) and the tax-related pages you find on the website for your state.

Suppose you were doing your estate tax planning in 2022, when the exemption amount magic number was $12 million. Assume your estate was worth $15,000,000, so you potentially have to worry about federal estate taxes on $3 million, right ($15 million minus the $12 million exemption)? Maybe! You've already used up $1,000,000 of your exemption amount through taxable gift giving even though you haven't paid any gift taxes yet. Therefore, you have a potential federal tax liability. Specifically, you may have to pay estate taxes on $4,000,000, calculated as follows:

1. **Take the $12 million exemption amount for 2022.**
2. **Subtract out the $1,000,000 you've already used up through gift giving.**

   You have $11,000,000 of your exemption left.
3. **Take the $15,000,000 value of your estate and subtract the $11,000,000.**

   Approximately $4,000,000 of your estate may be subject to federal estate taxes.

Why did we say that the $4 million *may* be subject to federal estate taxes? As we discuss in Chapter 13, you have several available deductions to further reduce your estate's value when it comes to tax liability, such as probate costs, funeral expenses, and appraisal fees. So, that $4,000,000 figure may be further reduced before applying any tax rate calculations.

WARNING

Don't assume that you can hire the hottest band on the radio for your memorial service, hosted on a yacht, and offset the $4 million with one heck of a party. The IRS will certainly look suspiciously on this and will most likely fight with your estate over the taxes you owe.

Even more important, regardless of your estate's value, you can make two deductions that enable you to avoid having to pay any federal estate taxes. Specifically, you can use the marital deduction and charitable deduction (see Chapter 13) to transfer significant amounts of property to your spouse or your favorite charities free of taxes. So, if you leave most or all your estate to your spouse or to one or more charities, then at least from a federal estate tax perspective, you don't have any concerns right now. You may be asking why this is allowed — well, without getting too deep into a tax policy discussion, it's because society thinks that allowing your surviving spouse to support themselves after your death is a good thing and giving to charity is probably a good thing for everyone, too!

WARNING

Even if you think you'll never have an estate worth more than this current high exemption amount, your estate could still face significant tax liability in certain states that have fairly high estate or inheritance tax rates! So, don't forget to check your state's taxes.

In some states, the estate and inheritance tax system has different rates that apply to different people to whom you leave property. Those rates vary by the relationship of those people to you — zero for charities and your parents or grandparents if you outlive them; a relatively low rate for your children and grandchildren, for example, but a fairly high rate for someone unrelated to you. Additionally, your state may have various rates that increase the more your estate is worth (in technical terms, a *graduated* tax system).

Therefore, you need to take a look at the answer to yet one more question — "Who gets what?" — as you've specified in your will and as set up in various will substitutes (see Chapter 6), such as joint tenancy with right of survivorship, or payable on death bank accounts. The answer to this "Who gets what?" question, in concert with "What is my estate worth?" and "What have I done so far?" helps you obtain an accurate picture of your total estate-related tax liability if you were to die today.

Looking out for tax traps

To assess your current estate-related tax liability, look for tax traps in how your estate is structured. One of the most common tax traps that can whack even the most modest estate with unanticipated and unnecessary tax liability is your life insurance policy. Most people have what is known as a term life insurance policy, which pays a fixed amount of money as long as you die within a certain number of years from the date the policy was purchased (if you purchase a ten-year term life insurance policy, you must die within ten years of your purchase in order for your beneficiary to collect the face amount, provided your premiums were paid in full). More often than not, the proceeds of this life insurance are used to pay off your expected debts (like your mortgage, car loan, and credit cards), plus the cost of your funeral, and leave a nice "bonus" to your family. Unless you're wealthy enough to afford a policy that will pay more than the $12 million federal exemption amount, you probably don't need to worry about planning around life insurance except possibly for state estate-related taxes, which may kick in at lower amounts.

TECHNICAL STUFF

As we discuss in Chapter 17, depending on how you've structured your life insurance — specifically, who owns your life insurance policy — the insurance's death benefit (that is, the amount of money that will be paid to one or more beneficiaries upon your death) may be added on top of your estate's value for federal estate tax calculation purposes.

For example, suppose your estate is valued at $11,000,000 and you live in a state that has neither an estate tax nor an inheritance tax, and you've never given any taxable gifts before. Most likely, you have no estate-related tax liabilities because your estate is worth less than the $12 million exemption — or so you hope. But suppose the following three items apply:

- You have a term life insurance policy (we define various types of life insurance in Chapter 17) with a death benefit of $1 million.
- You haven't taken steps to negate the federal estate tax bite, such as setting up a *life insurance trust* (see Chapters 8 and 17).
- You die in 2022, when the federal exemption amount for estate taxes was $12 million.

WARNING

Guess what? Even though you thought you were worth "only" $11 million, you were actually worth more dead than alive (scary thought, right?) with around $12 million likely subject to federal estate taxes (the $11 million value of your estate plus the $1 million life insurance death benefit) — even though your estate is really only worth $11 million until you die! You may ask why the taxes really matter. Well, very simply, because the tax rate is so high! Read on if it may apply, and you'll see how the estate tax rate is so much higher than the taxes you're paying today even if you're making NBA All-Star type of money.

Make sure that as you inventory your estate to determine its value, you work with your estate-planning team to look for tax traps in the following areas:

- Life insurance (the previous example can be a painful case in point!)
- Pensions, particularly any guaranteed future amounts that may be considered part of your estate even if you don't have the right to take distributions right now
- Other guaranteed future payments that may be considered part of your estate, such as future payments on deferred compensation, royalties, patents, monthly payments and balloon payments on money you've loaned out, and so on

Fortune Telling: Picturing the Future as Best You Can

Taking a snapshot of where you are today is fairly easy if you follow our suggestions earlier in the chapter. But most estate planning is based on some future scene — your circumstances in 5, 10, 20, 50, or even 100 more years! Impossible you say? We say that far-out tax planning is much more possible than you may imagine if you take care to:

- Predict (as best you can) your estate's future value when you die.
- Cross-reference your life-span possibilities (that is, various scenarios on how much longer you may live) against future estate-related tax liability, paying special attention to the exclusion (or exemption) amount magic numbers.
- Understand the tax impact of estate-planning strategies you already have in place.
- Consider the tax impact of likely or inevitable changes to your family situation.
- Make your best guess at future estate-related tax exposure.

Predicting the future

No, you didn't suddenly wind up at the state or county fair, walking down the midway and finding yourself beckoned over to the palm-reading booth. But *estate planning* does involve making some educated guesses about what may happen in the future.

Specifically, you need to make a rough guess about how much your estate will be worth when you die. Of course, few people know when they'll die, other than those who have a terminal illness and who have received a medical opinion as to how much longer they have to live.

For most other people, the best course of action is to look ahead to whatever an average life span is and how many years are left between now and then. For example, suppose you're a 35-year-old female, in fairly good health, and with a family medical history that doesn't have a lot of your relatives dying at relatively young ages. You may reasonably expect to live until 75, 80, or maybe even older, meaning that you can predict the future and settle on one particular target age — say, 80 years old.

Hopefully, you already have a general-purpose financial plan (and if you don't, consult with your accountant to develop one) that takes into account factors, such as:

- Your property's value
- Your property's expected future earnings, such as interest on your bank accounts and growth in your stocks, annuities, and mutual funds
- Your current and anticipated future income
- Anticipated significant future family expenses, such as your children's college education or weddings
- Additional expenses that are likely, such as caring for your own aging parents and your own anticipated medical expenses (as well as those of your spouse, if applicable)
- The age at which you plan to retire
- Some rough idea of ordinary living expenses during your retirement years, based on the lifestyle you anticipate and (as we discuss in Chapter 18) your retirement-versus-estate philosophy (for example, whether you specifically want to leave certain amounts of property behind for your children, grandchildren, or charities, or plan to spend as much of your money as possible during your retirement years)

If you're looking at a span of 30, 40, or more years between now and the age at which you're trying to predict your estate's value, your calculations may be way off. But that's okay, because all you're trying to do is get a rough idea of whether your future estate may be worth, say, $1 million or $10 million when it comes to estate-related tax planning.

If, however, you're close to retirement age — or maybe already in your retirement years — and you have a fairly accurate idea of how much of your estate you already are or soon will be spending during your retirement, then you can predict whether your estate's value will be

- About the same as it currently is
- More than it currently is (you're earning more in interest and retirement-years income than you're spending, meaning your estate continues to grow in value)
- Less than it currently is because you're gradually drawing down your estate's value to provide retirement-years living expenses

Regardless of your current age and your particular situation, you need to have some idea of your estate's future value so you can perform the next step — tax liability analysis — with some degree of accuracy.

Looking at several scenarios for the federal estate tax

As we discuss in Chapter 13, federal tax law makes tax planning the financial equivalent of skeet shooting. Good luck trying to hit a moving target! Exemption amounts and tax rates are likely to change every time Congress passes — and the president signs — a new tax law that impacts estate taxes. So, how can you possibly do any tax planning in such a volatile environment?

Okay, what's your best case scenario? That's easy! Congress passes — and the president signs — a repeal of the federal estate tax, meaning that no matter how much your estate is worth, you won't have any federal estate tax liability. If that's the case, why do any tax planning at all?

Well, your plan needs to be grounded in reality, not just wishes and hopes. And in this case, "past is prologue," as the saying goes. In 2001, Congress did, in fact, schedule the federal estate tax to be repealed in 2010, but guess what? The estate tax came back from the dead only a year later, in 2011. Then Congress changed the law again in 2017 and brought it back with that great big $12 million exemption we talk about.

Ah, but there's a catch: If the law isn't changed again, the exemption will actually go *down* again in 2027, possibly to an amount about half of where it is today. If that were to happen, then your best-case scenario where you didn't have to worry at all about federal estate taxes, no matter how much your estate was worth, is out the window. Even worse, under today's tax law, your estate may be immune from federal estate taxes, but one lapsed tax law later, all of a sudden your taxable estate may increase when the exemption lowers in 2027.

So, your best case scenario comes with a catch. By all means, be optimistic, even Pollyannish, but also be realistic and consider that even if federal estate taxes are scheduled to disappear or actually do disappear at some point, they can always resurface like the evil villain in the eighth installment of some horror movie series.

WARNING

Even leaving the feds out of the picture for a moment, you may still have an estate-related tax bite, even if your best-case scenario comes to pass. Your state may still have estate or inheritance taxes that don't go away, either temporarily or permanently. Or Congress may decide to keep the federal estate tax repealed, but still apply the gift tax and generation-skipping transfer tax (GSTT), as discussed in Chapter 10. Another concern: As we discuss in Chapter 10, if you receive certain government-provided medical care, your estate may get whacked for big dollars under the Estate Recovery Act.

So, in the best-case scenario, you can put a big fat zero in the column entitled "federal estate tax I may owe" because you won't have an estate tax or an exemption amount. But don't forget to consider other estate-related taxes and any related exemption amount magic numbers and other details.

WARNING

Again, as with the best-case scenario that has no federal estate tax, don't forget to check your state's estate-related taxes.

Blending your present strategies into the future

So far, from the preceding steps in this chapter, you have some key pieces of information with regard to estate tax planning and your future. Those keys are

- Your future estate's likely (or at least possible) value
- Some raw data with regard to three different taxation scenarios that you can cross-reference against your estate's value to predict future tax liability

Chances are, though, that if you're not a newcomer to estate planning, you've already followed some of the strategies that we discuss throughout this book, such as:

- Taking advantage of below-the-radar tax-free gift giving (see Chapter 11)
- Various types of trusts (see Chapters 7–9)
- The marital deduction for property you leave behind for your spouse, if doing so makes financial and tax sense

After looking at these items and noting which ones are already part of your estate-planning strategy, you can come up with a revised figure — we'll call it an *adjusted future estate value* — that more accurately represents what your estate is likely to be worth in the future, regardless of what it's worth now.

The adjusted future estate value figure you come up with is what you use as you move forward to the next few steps as you try to predict future estate-related tax liability.

Considering the impact of death, divorce, and other bum breaks

Significant changes in your life, such as divorce or your spouse's death, can dramatically affect your estate's value.

For example, if your spouse is terminally ill and will almost certainly die before you do, and if your spouse plans to leave their property to you under the marital deduction, then your estate's value will increase — perhaps significantly — after your spouse dies.

Similarly, if you expect a significant inheritance in the near future from an elderly relative who is in poor health, factor that inheritance into your calculations.

Or if a divorce is on your horizon, your estate's value will likely be lower if you expect that a significant portion of your estate will be lost as a result of the divorce settlement.

The important point to note is that when you try to figure out your estate's value in the future, you need to look at more than just the regular financially oriented factors (such as income, expenses, earnings on your investments, and so on), plus estate-planning strategies you already have in place. All factors are complicated enough when you look out more than a year or two. To complicate matters more, you need to look at significant life changes and try to understand as best you can how they may affect your estate's value.

Carefully comparing, betting the house, and rolling the dice

You have all the numbers you need: your estate's future value when you die, as well as three sets of tax-related data from the best-case, in-between-case, and worst-case scenarios. Now you need to compare the three.

First, look at the best-case scenario: no federal estate tax at all, but possible state inheritance or estate taxes and possibly other liability, such as Estate Recovery Act considerations. Based on what you think your estate will be worth, are you still looking at significant tax liability? Moderate tax liability? No tax liability?

Now look at the in-between scenario: a federal estate tax exemption amount that stays at $3.5 million. Now do the same comparisons, looking to see if you have significant tax liability, moderate tax liability, or no tax liability.

Finally, just as they say in shampoo commercials, “lather, rinse, repeat” — do the same comparisons and come up with the same significant/moderate/none answer for tax liability under the worst-case scenario of the federal estate tax exemption amount being at $1 million when you die.

The three answers you get for the three possible scenarios tell you how much estate-related tax-planning work you have ahead of you. If, for example, your answer under all three scenarios is “no tax liability,” then your estate-planning job is done! (Well, for tax purposes anyway — you still need to worry about your will, probate, insurance, and so on.)

On the flip side, if your answer under all three scenarios is “significant tax liability,” you have lots of work ahead. You specifically need to spend time with your estate-planning team looking at different tax-saving strategies.

If your answers are somewhere in between — for example, you have significant tax liability only if the federal estate tax exemption amount is $1 million, but otherwise you have either moderate or no tax liability — then you still need to consult with your estate-planning team. More likely, the basic trade-offs we discuss in the next section will be enough to reduce or eliminate estate-related taxes.

TIP

Whatever answers you come up with under the three scenarios, run your results past your estate-planning team at least once, just as if you were still in grade school and asking one of your parents to double-check your homework. You can do most of the planning work on your own, but get a professional opinion.

Deciding on Strategies and Trade-offs

We have good news for you: Most of the basic tax-saving strategies you can employ as part of your estate planning are very straightforward and simple and require very little effort and expense on your part!

WARNING

But we also have some potentially bad news: If you don’t plan carefully, you can really mess up your estate planning and wind up with a larger tax bill. And if you really mess up, your beneficiaries may get stuck paying more taxes.

So, use the following list as a starting point of tax strategies. Realize that each point has several alternatives available to you and, depending upon various circumstances, may or may not be advantageous. Also, you need to plan ahead beyond the most immediate tax consequences and consider down-the-road tax consequences as well.

The most common estate tax–related strategies available to you include

- If you should give property to someone as a gift or if you should leave that property in your will
- Whether you should leave all your property to your spouse
- How to structure your life insurance policy or policies
- Whether you should use gifts below the exclusion amount
- How to use double dipping on tax savings from charitable gifts

Gifting versus leaving property as part of your estate

Suppose you and your spouse have a vacation home that you purchased 20 years ago for $50,000. (Imagine it was a real fixer-upper!) Over the past 20 years, you've put about $100,000 in renovations into the home, and — even better — property values in that area have gone way up. In fact, your vacation home is now valued at $500,000, according to the most recent appraisal.

For the sake of this example, the home is entirely in your name rather than jointly owned with your spouse, meaning that the $500,000 value is entirely within your estate.

You decide to give the house to your oldest daughter — a freelance writer who wants to live in a secluded location. You have two options available. You can:

- Give the home to your daughter as a gift (being the generous parent you are)
- Leave the home to your daughter in your will as part of your estate or through a trust

Suppose you decide to give the home as a taxable gift. The home's value — $500,000 — becomes the starting point for figuring out any gift tax liability. As we discuss in Chapter 11, in 2023, you have a $17,000 annual exclusion on gifts that reduces the taxable amount to $483,000 ($500,000 minus $17,000).

If, however, you decide to hang onto the home and leave it to your daughter as part of your will — the entire $500,000 would potentially be subject to federal estate taxes.

TECHNICAL STUFF

But forget about the $16,000 difference, because that's not the point we want to make. Assume that your estate isn't subjected to any federal estate taxes at all because in the year you die, your estate's value is far below that year's exemption amount. In fact, the value is far enough below that even if you had given the home to your daughter as a taxable gift and, therefore, used up part of your combined gift-and-estate exemption amount and unified credit (see Chapter 11), you still don't have to worry about federal estate taxes.

For purposes of your estate, either giving the home to your daughter as a gift or leaving the home to her as part of your estate has the same tax impact on your estate: zero. However, from your daughter's perspective, receiving the home as part of your estate likely will cost her much less in eventual taxes if she ever decides to sell that home than if she had received the home as a gift.

Why? The answer lies in how the tax basis of the home is calculated and how, for estate purposes — but not for gifting purposes — that tax basis is "stepped up" to the current value of the home at the time it was transferred.

Don't panic! We explain what we mean, step by step. You may recognize the first part of this puzzle — calculating the tax basis — if you have ever owned and sold a home. To overgeneralize a bit, the tax basis of any property (not just real property like a house but any property, even including your stocks and mutual funds) is usually calculated as the price you paid for that property, plus any improvements you've made. (In the case of stocks and mutual funds, those improvements include dividends and capital gains that you reinvest.) In this example, the tax basis of your vacation home is $150,000: your original $50,000 purchase price plus the $100,000 in renovations you put into the home.

As we note earlier in this chapter, if you leave property to someone upon your death as part of your estate, the value of that property is stepped up to the current value. Now your daughter inherits a home worth $500,000, and that same $500,000 figure is her tax basis in that property. Assume she doesn't make any further improvements, and ten years later she sells that home for $700,000; she would potentially have a taxable gain of $200,000 (the $700,000 she received minus her $500,000 tax basis).

If, however, you give the home to your daughter as a gift, she doesn't receive a stepped-up basis and instead receives the same tax basis in the property as you had: $150,000. So, if she were to someday sell that home for $700,000, her gain would be a whopping $550,000 ($700,000 minus her $150,000 tax basis) rather than the $200,000 if she had received the property from your estate upon your death.

Depending on the tax laws governing the sale of primary residences, your daughter may never owe any capital gains tax, regardless of the home's value or how low the tax basis is. So, for a house, as in this example, the gift-versus-estate consideration may be different than for stock or anything else that doesn't qualify for the primary residence tax break. However, this tax break, the rules for rolling over gains, and the amount of the final tax break have changed occasionally in recent years. As with pretty much everything else in tax planning, you need to look ahead, make some educated guesses, and consult with your estate-planning team!

REMEMBER

The two key points to remember are these:

- For purposes of your estate, the federal estate and gift tax impact of giving property as a gift is more or less the same as leaving that property as part of your estate.
- For the person to whom you give or leave the property, the down-the-road tax impact may be very different depending on which choice you make!

WARNING

As previously discussed, the federal estate gift tax laws changed in both 2001 and 2017, affecting the basis rules as well. As you continue to plan with your tax and legal professionals, be mindful of the changes that may or may not take effect in 2026.

Imagining the ups and downs of leaving your estate to your spouse

Many married people automatically set up their wills and their overall estate plans to leave their entire estates to their surviving spouses. But they could be walking into a trap!

Suppose both you and your spouse have estates that are slightly below the federal estate tax exemption amount. Also suppose that you die before your spouse does, and you leave all your property to your spouse. Now suppose your spouse dies shortly after you do, with most of the property that was once yours still unspent and part of your spouse's estate. Guess what? Federal estate taxes probably come into the picture because by leaving your estate to your spouse, you created a situation where estate taxes kicked in. Now your spouse's new, larger estate is higher than the exemption amount.

TECHNICAL STUFF

The future federal estate tax implications of leaving everything to your spouse can be avoided with some very sophisticated tools and depend upon the status of the federal estate tax law pertaining to a concept known as *portability,* a process where a surviving spouse can pick up and use the unused estate tax exemption of a deceased spouse. Check with your estate-planning team to see if portability is something that may be applicable to your estate.

TIP

When deciding whether to leave property to your spouse, look ahead and figure out if you're creating a tax liability that you can avoid. (You can leave your property to your children or someone else, or place your property into a trust for your spouse.)

Avoiding estate taxes on your life insurance proceeds

In Chapter 17, we discuss the potential federal estate tax impacts on proceeds from your life insurance. Make sure that you structure your life insurance policy or policies to avoid an unpleasant surprise from the estate tax agents.

Using gifts below the exclusion amount

In Chapter 11, we discuss the annual exclusion available to you for giving tax-free gifts. You can give gifts to anyone up to the exclusion amount (currently $16,000, and later adjusted annually for inflation) without having any tax impact at all or even using up your unified credit against down-the-road estate taxes.

If you have cash, investments, or other property that you're certain you'll leave to certain people — your children, for example — and if your estate is valuable enough that federal estate taxes will apply, then why not transfer that property now as gifts in small-enough chunks to stay below the gift tax radar and, therefore, lower the value of your taxable estate?

Why not, indeed? Go for it!

REMEMBER

Make sure that you consider the tax implications of gifts while you're alive versus property that someone receives after you die — specifically, carryover basis versus stepped-up basis. Check out the "Step right up" sidebar in Chapter 2.

Double-dipping on tax savings from charitable gifts

The charitable deduction for gifts that we discuss in Chapter 11 allows you to give gifts to qualified charities without worrying about gift taxes.

But guess what? You can double-dip on the tax savings front and also take an itemized deduction on your federal income taxes for those same gifts! So you're not only skipping out on gift taxes and reducing the amount of future estate taxes, but also saving more money on your federal income taxes! And if your state allows you to itemize deductions on your state income tax and to include charitable deductions, you can save even more!

So, why not get two or even three tax deductions out of the same charitable gift?

Just as we said in the preceding section, why not, indeed? Go for it!

Putting Together a Comprehensive Estate-Related Tax Plan

What's that? You're still a bit uncertain about where to start? Just follow the steps in this section and, before you know it, the tax portion of your estate planning will be well within your control.

Fixing the holes

You've identified the problem areas in your estate plan that may cause your estate to get hit with unnecessary taxes, so do something about those problems — right now! If, for example, your life insurance is poorly structured so the death benefit amount would cause an otherwise nontaxable estate (for federal estate tax purposes) to be taxed, then create a life insurance trust (see Chapter 8) or otherwise change your life insurance policy's ownership (see Chapter 17).

Starting on that gift giving

One way or another, the ownership of every single piece of property in your estate eventually is transferred to someone else in some way — through your will, through your state's intestacy laws, through a will substitute such as joint tenancy, through a trust, or through a gift. You really can't take your property with you, and if you've already given serious consideration to the many beneficiary decisions when you prepare your will, why not give certain property away now or in the near future instead of waiting until after your death for that property to be transferred? Not only can you smooth out the property transfers in your estate by regularly giving gifts, but you can also keep a substantial amount of the overall property transfer tax-free by keeping the gifts below the annual exclusion amounts.

TIP

You can take the complete inventory of your estate that you created (see Chapter 2, as well as our discussion earlier in this chapter) and divide the list into three columns:

- The intended recipient (person, charity, foundation, and so on) for that property

- Whether you want to give that property as a gift rather than wait for it to be transferred as part of your estate
- The year(s) in which you want to make the gift

You can also split up certain property to keep the gift amounts below the annual exclusion amounts and further reduce any potential tax exposure. For example, if you have 1,000 shares of a stock that's relatively stable in price, and the current price per share is $50 — meaning you have $50,000 worth of stock — you may decide you want your oldest daughter to receive that stock to start her own portfolio. Instead of giving her the entire 1,000 shares in a single year, which means that part of the gift is taxable, you can give her just enough shares this year, next year, and the following year (and so on) to stay beneath the annual exclusion radar of $16,000 (or whatever the figure adjusts to each year along with inflation, as we discuss in Chapter 11).

Setting up trusts if necessary

In Chapters 7, 8, and 9, we discuss various types of trusts, many of which you can use to reduce or eliminate tax liability on your estate. Don't go overboard — that is, don't set up all kinds of trusts (and pay lots of fees to your attorney or financial planner) if you don't really need to. By all means, set up the trusts you need to help prevent an unnecessary tax bite.

Planning ahead for property transfers upon your death

How much should you plan ahead if you leave all your estate to your spouse? How about part of your estate? Or maybe none of your estate to your spouse? Should your spouse leave their estate to you?

Part of your beneficiary decisions specified in your will or through various types of will substitutes must include estimating the tax impact. If your state has an estate or inheritance tax, pay particular attention, because chances are, even if you can sidestep the federal tax bite, your estate may get hit hard by your state. The key, just as with every other aspect of estate planning, is to plan ahead!

REMEMBER

Schedule a meeting with your estate-planning team to discuss what tax-planning ideas may make sense for you and the pros and cons of each.

5

Estate Planning for Family Businesses

IN THIS PART . . .

Work estate planning into your family business future.

Guard against unpleasant estate-related surprises that could derail your family business.

IN THIS CHAPTER

» Defining family business

» Understanding how the various forms of business ownership impact your estate

» Determining what your family business is worth (cha-ching!)

» Identifying the key estate-related decisions that face owners of family businesses

» Looking at the major estate-related challenges to family businesses

Chapter 15
Grasping the Basics of Estate Planning for Family Businesses

If you're involved in a *family business* — whether a small retail store, a farm, a start-up, a side hustle, or even a factory — you probably spend most of your time just running the business. That's plenty to keep you busy!

Quite possibly, you've been so consumed with day-to-day operations and general business planning that you haven't had much time to think about estate-planning concerns for your business — like what happens to the business when a key family member dies. Will you potentially have to sell the business to settle the estate?

Other questions need answers, too, like how the legal structure of your business affects estate planning and how much the business is worth in the marketplace. In this chapter and in Chapter 16, we present you with a concise reference on the various topics that are most important for your estate-planning considerations: business valuation, key estate-planning decisions you need to make, succession planning, ownership transfer, and estate taxes.

Defining "Family Business"

The lemonade stand that you and your sister had when you were in the fourth grade is a family business. The retail store that your father began and that has morphed into an online business that you and your brother now manage is a family business. Even some global Fortune 500 businesses started as family businesses! In fact, according to the U.S. Census Bureau, only 10 percent of businesses are not family-owned or controlled. That's a whopping nine out of ten businesses that are defined as family businesses! And family businesses employ approximately 50 percent of the U.S. workforce and produce half of the country's gross domestic product (GDP). All hail family businesses!

For estate-planning purposes, we focus on the definition of family business that helps you qualify for certain tax breaks. (You need these tax breaks if you want to keep your business in the family.)

First and foremost, the family or families involved must own a significant portion of the business. If only one family is involved, a minimum of two family members must own at least 50 percent so they have majority control. If two families are involved, their combined ownership must be at least 70 percent. And if three families are involved in the business, their combined ownership must be at least 90 percent. Therefore, you can own a business with your family members and with outsiders (that is, people not related to you) and still have your business classified as a family business — and qualify for the pertinent tax breaks.

In addition to the ownership requirements, the business must be privately held — that is, not listed on a stock exchange and available for public trading — within the past three years. Check with your accountant or financial planner if you have any questions or concerns in this area.

Another requirement (incidentally, these requirements come to you courtesy of the IRS) for determining whether a business is a family business deals with the ever-popular IRS term *materially participated.* If you fill out any business-related income tax return, such as a Schedule C or Schedule F (for a farm), you're familiar with this phrase because the IRS wants to know if you're really in business or just messing around trying to get tax deductions. When it comes to potential estate-tax breaks, the person who just died and whose estate is being settled must have "materially participated" (that is, really worked) in the business for at least five of the eight years before they died.

TIP

The IRS has a *material participation test* to see if a person really has worked in the business. They use seven tests as benchmarks for this determination, including the number of hours worked in the business. In fact, the majority of the tests involve various measurement of hours worked in the business. This is why it's important to actually keep track of the hours you work in the business.

Additionally, the person who inherits the business must likewise "materially participate" in the business in the years ahead — specifically, during the ten years after the former owner's death, an eight-year period is designated, and the inheritor must materially participate in at least five of those eight years. (Whew!) Also, the inheritor must be a family member or an employee who worked in the business for at least ten years before the owner's death.

TIP

Getting a bit complicated, huh? Many more requirements come together to determine whether a business is considered a family business. Our advice: Check with your accountant and see if your business meets all the pertinent regulations.

Making the Critical Estate-Related Decisions Up Front

Anyone who owns and manages a family-owned business has thousands of decisions to make in the course of day-to-day operations: whether to turn the restaurant's menu into all-vegetarian, whether to expand to a new city, how many new employees to hire — the list goes on and on.

But in this chapter, we focus on a small number of estate-related decisions for your family business and what areas you need to regularly revisit to see if circumstances have changed. Depending on the decisions you make, some of the estate-related challenges we discuss in the next section may not be problems at all for your family business — or, on the other hand, you may have your hands full trying to head off a full-blown estate-planning problem!

You need to decide the following key points:

- Whether you want to continue your current level of involvement and investment in your family business and for how long
- Whether the business's ownership picture should change (we discuss your choices later, in "How the Form of Business Ownership Affects Your Estate")

» What your succession plan is (deciding who will take over running your business from you, and under what circumstances), both for you personally and (if applicable) for other family members involved in the business

Choosing to stay or go

We're guessing that you want to stay in the business. After all, you've devoted your life to it! Okay, so how long are you going to stay? Think carefully, because your decision goes beyond just your business and actually affects *all* of your estate planning.

Beyond the obvious career-oriented aspect of this decision, you need to understand how this decision affects your estate's structure and value. Assume that you intend to maintain your current level of involvement in your business for as long as you live, and you never intend to sell or give your share to anyone else. If so, then your estate's fate and value are closely aligned with the fate and value of your business.

REMEMBER

Even if you have significant assets in your estate that aren't directly related to your business, those assets may still be exposed if your business is a sole ownership or partnership. (See the section, "How the Form of Business Ownership Affects Your Estate" in this chapter.)

If your intention is "to be carried out feet first from behind your desk," then you need to:

» Make sure that you have adequate insurance (short-term and long-term disability, business interruption, liability, and the other types we discuss in Chapter 17) to protect your business and, by extension, your entire estate.

» Spend significant time on estate-tax planning (as we discuss in Chapter 16) to minimize the business and financial impact upon your death and, if possible, take advantage of the business-related estate tax breaks.

You may, however, seriously think about ending or at least scaling back your involvement and investment in your business. You're probably getting tired of the long hours, or you see potential troubles on the horizon. (Maybe you see some drastic changes in your industry, or some powerful new competitor is planning to move into your area.) Perhaps your business is so significant a portion of your estate that you're worried a business downturn could devastate your estate, and you want to diversify.

If so, consider the points we make in the following section about how your family business ownership picture may change and how you can plan for the impact on your estate.

Adjusting the family business ownership picture

Suppose you and your three sisters are all equal co-owners of a local restaurant, and you decide you want to retire. You have a number of options available to you, including the following:

- Having your three sisters buy you out in equal amounts, leaving each of them owning one-third of the business
- Having only one of your sisters buy you out, with that sister now owning 50 percent of the business and the others still owning 25 percent
- Selling your ownership to another family member — a cousin or maybe your oldest daughter — who then is an equal co-owner with your three sisters
- Selling your ownership to one person who isn't a family member, who then is an equal co-owner with your three sisters
- Selling your ownership to several people who all together own 25 percent of the business (each owns a smaller percentage of the overall total business) — they plan to expand the business and anticipate that their ownership shares will increase in value
- Giving your ownership as a taxable gift (by taking advantage of the gift-tax marital deduction we discuss in Chapter 11, no gift taxes apply) to your spouse who is ready to retire from a 30-year government career and who now is a 25 percent equal co-owner with your three sisters while you find something else to do (including maybe just relax!)
- Giving your ownership as a taxable gift to your oldest daughter, which reduces your estate's value by your share of the business but still counts against your combined gift- and estate-tax exemption amount and unified credit (see Chapter 11)

You can probably think of many other possibilities, but for what we want to point out, the preceding list is complete enough. If you look at the various alternatives, some key points jump out:

- If you sell your ownership and receive full price, your estate's value probably won't initially change much because you're exchanging one type of property — business ownership — for another type of property — cash (more on that in a moment). However, you still owe capital-gains taxes on the difference between what you received and your tax basis in the property (*tax basis* is an IRS term for cost — in general, what you paid).

- If you don't receive all the cash up front and instead allow the purchaser(s) to pay you over time, your estate may include the future guaranteed value of those payments. (If you die before receiving all the payments, the necessary cash to pay federal estate and any state inheritance or estate taxes may not be readily available.)
- If you sell your ownership in your family business to a larger business and receive stock instead of cash, you need to be aware of possible restrictions you have with the stock. For example, the law may restrict you from selling any stock for at least one year, and the law may limit you from selling certain amounts over the next several years. Aside from the obvious financial diversification and general financial planning, realize that a sudden and dramatic drop in the stocks' value can cause your estate's value to go way down.
- If you give away your ownership as a gift, your estate's value decreases by the same amount of your ownership. Depending on to whom you give your ownership, gift taxes may or may not apply.
- If you sell your shares to someone outside your family, you may change the designation of your business as a family business, eligible for some specific estate tax breaks and treatment, to a business that is no longer a family business. The IRS is rather particular about what is and isn't a family business, so any change in ownership may potentially affect how your business is classified and treated.

REMEMBER

The main point: If the ownership structure of your family business changes, it can have interesting (and sometimes unwelcome) future effects, not only on your estate but also on others' businesses and estates. You definitely need to understand what an ownership structure change will do to both your family business and estate plan *before* making these changes. After the changes are made, they sometimes can't be undone (at least not without significant cost and time).

Deciding on your succession plan's details

Whether or not you plan to exit your family business over the next several years, upon retirement age (which can occur at almost any time but typically from your 50s on), or upon your death, you need to have a succession plan in place. And *succession plan* does not refer to how you intend to binge-watch the HBO mega-hit *Succession!* A succession plan determines who takes your place and under what circumstances.

Beyond the business-operations side of succession planning, you have estate-planning considerations. For example, your succession plan for business operations may be indistinguishable from how you plan to dispose of your ownership in the business. That is, if you give your sole-ownership business to one of your children or sell the business to your brother, or if perhaps you plan to leave the entire business to one of your children as specified in your will, then the family member who receives or inherits the business now is in charge of running the business.

TIP

Get the person involved in the day-to-day business operations several years before you anticipate their taking over. You want to have ample time to share all the important information about how to run the business. This is often one of the biggest mistakes family business owners make. Don't assume that just because another family member has been involved in some aspect of the business, they know all the details that you personally do to run the day-to-day operations of the business. ***Remember:*** The devil is in the details!

Alternatively, you may want to put a succession plan in place where someone succeeds you as the day-to-day manager or operator of the business, but you still retain at least partial ownership. Perhaps the new manager/operator spends at least a couple years on a trial basis before you give or sell the business to them.

TIP

A *trial basis* is one of the best things that can happen for a family business succession plan, as well as your estate plan. A trial run provides all parties with the opportunity to see if the succession plan works. The annals of family business history are littered with failed succession plans! The last thing you want is to put the succession plan into play only to have the family member taking over decide that they really don't want to run the business or, just as bad, they aren't good at it and run it into the ground. Goodbye, business — and goodbye a major part of your assets that comprise your estate plan.

If your family business isn't a one-person show and you have other relatives as partners or co-owners in a corporation, you each need to have a succession plan that may or may not include bringing in outsiders versus taking over for each other.

You also need to have temporary succession plans (what happens if you have to take a year or two off because of a serious medical problem?) versus permanent succession plans.

You can probably think of dozens of other possible succession possibilities. Just remember that succession planning is critical to preserving your family business and, therefore, preserving your estate's value. You may also decide not to have a succession plan, which means when you retire or die, your sole-ownership business goes away.

WARNING

Most likely, though, your business will have at least some value for estate-planning purposes. Whether you like it or not, the business will be part of your estate and subject to estate and inheritance taxes.

So, think of succession planning as one more business decision you need to make that affects not only the future of your business, but also your estate's health and value.

How the Form of Business Ownership Affects Your Estate

You can find various legal forms of ownership for family businesses (as well as businesses in general), such as:

- Sole ownership (also called sole proprietorship)
- Partnership
- Corporation
- Limited partnership
- Limited liability company (LLC)

Each of these ownership models has its advantages and disadvantages. In the following sections, we briefly introduce each ownership type and point out specific concerns and issues that you need to know for your estate plan.

Sole ownership: Everything is mine!

If you own a business, receive all the profits from that business, and are responsible for the business's debts and liabilities, then your business is considered to be a *sole ownership* (or *sole proprietorship*).

TECHNICAL STUFF

You may operate the business in your own name, or alternatively you may use a business name, such as Joanne's Consulting Services. (In formal terms, this would be called a *fictitious business name* or *assumed name.*) From an estate-planning standpoint, sole ownership businesses have the advantage of being relatively simple, with less costs for setup. From a tax perspective, you don't need to deal with obtaining an employer identification number (EIN), which means less paperwork. Your business is closely interwoven (some even substitute the term *intertangled*) with your personal financial and legal picture. As you inventory your estate, you need to remember that a major chunk of your estate could be your business.

However, sole-ownership businesses have significant downsides that are downsides for your estate, specifically:

- **Responsibility for debts and liabilities:** If your business starts losing money and never recovers, you're responsible for all the business loans and other liabilities, such as leases on retail or office space. Consequently, if you have to cover those debts and liabilities, you can seriously damage your overall estate. You may even find yourself having to sell other nonbusiness property — your stocks, or maybe even your home — to cover your business obligations. In the worst case, you don't have enough nonbusiness property to cover your debts and liabilities, and you may need to consider desperate measures up to and including bankruptcy.
- **Legal exposure:** Someone who sues your business is actually suing you, and even the nonbusiness side of your estate (that is, your personal investments and your home) can be severely damaged by having to pay for a judgment or a legal settlement.

  WARNING

  Most estate-planning professionals, including accountants and attorneys, do not look favorably on sole ownership. The assets of the business are the assets of the owner; they're one and the same. Additionally, the liabilities of the business are the liabilities of the owner. There is no separation! Your fortunes and failures in the business are a mirror of you, which can impact your financial security and your estate plan. ***Remember:*** Estate planning is about protection and control. This form of ownership can jeopardize the protection tenet.

  TIP

  As we discuss in Chapter 17, several types of insurance provide protection against the financial loss and harm that can come from lawsuits. If you're in business, make sure that your current insurance coverage protects your estate from legal liability incurred by something that happens in your business. You can also broaden your current coverage for business-related exposure or purchase liability insurance that specifically covers your business operations.
- **Succession planning:** We talk later in this chapter about the challenges of succession planning in family businesses (deciding who will take your place and under what circumstances). If you're the only owner, then you must look elsewhere to find someone to succeed you.
- **Business interruption:** If your sole ownership business is a small, one-person operation, and you become ill or disabled for an extended period of time, or even permanently disabled, your business operations may not survive. Aside from the lost income, you may erode or even wipe out your

estate by having to sell property to cover regular living expenses — even if you have adequate health insurance. As we discuss in Chapter 17, look into long-term disability and long-term-care insurance (even if you're a business owner rather than an employee of another company) to protect yourself.

TIP

Business interruption insurance is typically a part of a business owner's policy (BOP), which is designed to protect your business through general liability insurance and commercial property insurance, along with other protective insurance components. You get a lot of bang for the buck with business interruption insurance, so make sure to include it as a part of your BOP package.

Partnership: We're in this business together

Many family businesses begin as partnerships. You may go into business with your brother and sister, for example. Or perhaps your father has operated a family business as a sole ownership for more than a decade, but now that you've graduated from college, you decide to join the business as a partner.

All the estate-related downsides listed for sole ownership are usually downsides for partnerships, but sometimes with a twist. For example, the financial and legal exposure also spills over into the personal estates of the partners, but it can actually be even more of a problem. Why? Because any partner can create a financial or legal obligation on behalf of the partnership that, if things turn sour, obligates all the partners. For example, if you're partners with your sister and brother, and your brother causes the business to be sued, you and your sister are just as responsible as your brother to pay any settlement or judgment. You can't escape other family members' actions in a family partnership, another twist on "what's yours is mine," but typically in a potentially negative legal obligation way.

Therefore, partnership forms of family business ownership can cause significant (and sudden) problems to the estates of all the owners, regardless of which partner caused the problem.

On the positive side, though, if your brother turns out to be a business and financial genius, and his ideas are the chief reason the business is wildly successful, your estate and your sister's estate actually benefit from your brother's ingenuity. Profits of the business flow through to each of the partners according to their ownership shares. Therefore, you sometimes find one or more partners going along for the ride on another partner's coattails — the one who turns out to be the driving force behind the business's success.

But back to the negative side: If you and your sister are riding your brother's coattails, he may resent being the brains behind the business. He may decide that he really doesn't need to be in business with his siblings. Leaving aside the family discord, if the owners begin fighting among themselves and decide to dissolve the partnership, they can damage the business. And, depending on the business's current status (how much debt is outstanding, what lease obligations exist, and so on), the dissolution may erode or wipe out all the partners' estates to cover the partnership's obligations.

Even with multiple partners, business interruption can be a problem. If three sisters operate a chain of retail stores, two of the sisters may cover management responsibilities if one sister becomes disabled or ill for an extended period. However, suppose those same three sisters operate a small consulting company, and each spends the majority of her time on billable work. If one of those sisters is absent from the business for an extended period of time, the other two won't be able to pick up the slack because each one is already spending most of her time working for and billing her own clients. The result may be that business revenues and profits drop significantly, possibly to the point where debt and lease obligations can't be fully covered. As a result, the partners have to dip into their own estates to make up for the revenue and earnings shortfall from the business interruption.

I KNOW MY RIGHTS!

If your family business is a partnership, you and your partners must follow a couple of very simple rules to make sure you avoid confusion at estate-planning time.

First, make sure that you don't commingle your personal funds and property with the partnership. If a family member needs to provide a personal loan for business cash flow purposes, this has to be documented carefully and must be treated as if it were a loan from a third-party like a bank or investor.

Second, make sure that you and your partners decide and very clearly state in writing who owns what in the partnership. If, for example, you and your three sisters equally co-own a partnership business, then you need to create agreements and file all the applicable financial and tax paperwork that indicates that each of you owns 25 percent of the business. When it comes to your estate planning (as well as the estate planning of your sisters/partners), that clearly stated 25 percent is important when determining the value of partnership property that needs to be included in your estate, any shares of partnership income that are due to your estate, and related estate-planning factors. This is a prime example of it being better to over-document partnership information so anyone, not just the family business partners, can clearly understand the pertinent information of the business.

WARNING

This situation often is the beginning of the end for family partnership businesses, because old hidden family resentments boil to the surface. Why risk family harmony because of shortsighted family business and estate planning?

Corporation: Limiting your liability

Corporations are an attractive form of business ownership for one primary reason: The corporation's owners generally have limited liability when it comes to the amount each owner has invested in the business. Unlike sole ownership and partnerships, where personal estates can be devastated if business turns bad or the business is successfully sued, in a corporation, most of an owner's estate *may* be protected against such an unfortunate turn of events. (It's sort of like having Captain America's shield of protection! However, some caveats are attached to that shield.)

We say "may" be protected because, quite possibly, as an owner of a family business corporation, you may have almost all your property tied up in the business, with very little personal property outside your share of the corporation. So, depending on your particular circumstances, if your family business corporation goes down the tubes, your estate can still be severely diminished as a result.

Don't automatically assume that a corporation has thousands or millions of owners (shareholders) and must be a multibillion-dollar global behemoth, like Microsoft or General Electric. Small or moderately sized family businesses are often structured as corporations primarily to receive the limited-liability benefit. However, a downside to corporate forms of ownership is *double taxation.* With double taxation, the IRS taxes business profits through corporate taxes, and the IRS again taxes the money that owners receive as dividends, salaries, and bonuses through personal income taxes.

TIP

A way around this double taxation is to structure your business as an S corporation, which allows more money to be sheltered from various forms of taxes — and, therefore, increases the business owners' estates. But note that the rules for S corporations can be complicated and have some disadvantages themselves, so consult with your tax adviser and attorney before electing S corporation status for your family business.

TIP

Family businesses structured as corporations are at least slightly less susceptible to estate-related problems (such as financial and legal obligations, business interruption, and succession planning) than sole-ownership and partnership businesses. Depending on the breadth and size of the family corporation, you often find more official succession plans and strategies for business interruption than you do in relatively small family partnerships. As a result, the corporation and the owners' estates may not be affected as significantly if the business goes sour.

Limited partnership

Many family businesses that are heavily oriented toward investment activity, such as in real estate or thoroughbred racing horses, are structured as *limited partnerships.* A limited partnership possesses some of the characteristics of both a partnership and a corporation.

A limited partnership has two types of partners, and to qualify as a limited partnership, your business must have at least one of each type:

- **General partner:** Think of the general partner as the person in charge of the partnership. General partners are personally liable if the limited partnership can't pay its liabilities and debts.
- **Limited partner:** A limited partner is more like a shareholder of a corporation (including a family business corporation) with liability limited to the amount invested in the limited partnership. But a limited partner in a family enterprise (or any limited partnership) must take care not to get involved in daily operations of the business. The law says you can lose the protection of limited liability if you mess around in management. This is a definitive line that cannot be crossed if you want to retain limited partner status.

Limited partnerships are taxed like regular partnerships. General and limited partners report all income and losses directly on their own tax returns.

TIP

If you're a limited partner in a family business, ask your accountant and attorney to double-check all paperwork to make sure that your estate isn't exposed to any unexpected liability because documents were filled out or filed incorrectly.

WARNING

If you're a general partner in a family business, then you not only have the same estate-planning considerations we discuss for regular partnerships, such as debt and liability exposure for your estate, but you also have the responsibility of protecting the limited partners' investments. Irate limited partners can be nasty if your actions cause the investments to go sour — especially when those limited partners are your own relatives in a family limited partnership. Thanksgiving get-togethers may be a bit strained for a while if the estates of the limited partners take a big-time hit because investments go bad!

Limited liability company: A reliable, easy go-to

A *limited liability company* (LLC) is a separate legal entity like a corporation. However, an LLC differs because its members report the LLC's financial results directly on their own tax returns without dealing with the double taxation issue. Furthermore, the LLC doesn't pay any taxes.

No member of an LLC is personally liable for the business's debts or liabilities, and the LLC passes profits or losses directly to its members.

From an estate-planning perspective, the characteristics we mention for an LLC (limited personal liability, avoiding double taxation of profits, and so on) can benefit your estate's value by protecting the nonbusiness side of your estate if business goes bad, as well as helping to increase your estate's value by sending money that would otherwise get hit by double-taxation into your estate.

REMEMBER

Many state laws restrict the life of an LLC to a maximum of 30 years. So, be sure to check with your estate-planning team on your own state's rules regarding the life of an LLC. The last thing you want is to set up the family business as an LLC only to eventually find out that your estate plan based on the LLC is no longer valid.

Calculating the Value of Your Family Business

Before you begin to develop an estate plan for your business, you need to determine the value of the business just like any other property in your estate.

You most likely have some subjective feelings about your business, somewhere between "My business is my entire life" and "Yeah, it's a nice investment, but that's about it." However, for valuation purposes, you need to go beyond your subjective feelings and arrive at a precise value. As difficult as it may be, your feelings about the business are immaterial with respect to valuation.

REMEMBER

We discuss the concept of valuing your property according to *fair market value* in Chapter 2. But to have a fair market value for any property, you need both a willing seller and a willing buyer. In the case of a family business, regardless of the form of ownership, you very often don't have a willing buyer because, quite simply, the business isn't for sale.

So, where do you begin as you try to figure out your business's value? Start by looking at the business's financial performance. Financial analysis can include some of the following benchmarks:

- Book value
- Discounted cash flow
- Sales multiple
- Liquidation value

The following sections briefly examine these various benchmarks that you and your estate-planning team can use to figure out your business's value. You need this figure:

- When you plan to sell some or all your ownership portion of the business, perhaps as part of your estate-planning strategy
- Upon your death, when one or more of your beneficiaries inherits your ownership share and estate taxes need to be calculated

Book value

You use a simple formula to come up with your business's *book value:*

Assets – Liabilities = Net Worth

Your business's assets include all money, property, and *receivables* (amounts owed to the business). The assets can further be classified as

- **Capital assets or fixed assets:** Those items that can't easily be turned into cash (like a building)
- **Current assets or liquid assets:** Those items that can be easily turned into cash (like whatever your business sells)

Business liabilities are all your business's legal obligations, debts (money owed), or responsibilities.

Finally, the net worth is simply the difference between your business's assets and liabilities (and, with any luck, you have more assets than liabilities!).

TIP

If you ever wondered why Microsoft Excel, Google Sheets, and their spreadsheet ancestors were invented and became so widely used, here you have it! Your business assets and liabilities are precise, factual numbers from your financial reports. Nothing here should be an estimate or a guess. "I'm guessing a number" cannot be part of the book value calculation.

Discounted cash flow

TECHNICAL STUFF

Discounted cash flow can be confusing, so talk to your attorney or accountant. To oversimplify a bit, the faster your business grows, the higher the value that you'll arrive at using discounted cash flow calculations. Did you follow that? Take our advice and seek counsel.

Sales multiple

You get a *sales multiple* by multiplying your business's sales numbers by an industry-specific standard to obtain a valuation. Most types of businesses — whether retailers, manufacturers, or restaurants — have some type of industry-wide *multiplier* (the "constant" for that industry you use in your calculations). Take any business that falls within the industry and multiply a financial benchmark to obtain a valuation. For example, you calculate the value of a family restaurant business by multiplying the restaurant's sales by the industry-wide restaurant multiplier.

TIP

Sales multipliers change over time, and often rather quickly from macroeconomic factors, so be sure to check with your specific industry trade group or professionals in your business field.

Liquidation value

Your business's *liquidation value* is based on the amount of money your business would receive if all its assets were sold. Think of liquidation as it sounds — turning something into liquid (or cash), which is easier used than something in a solid state. (Isn't good old cherry Jell-O easier to slurp when you're in a sickbed when the gelatin is liquefied and runny? Or, isn't cash easier to spend than a building or piece of equipment?)

Take your business's liquidated assets minus the debts and liabilities and you have the liquidation value.

TECHNICAL STUFF

Don't confuse liquidation value with book value, even though the equations are nearly identical! Often times, liquidation values are associated with a quick sale of a business's assets, such as a going-out-of-business sale, which means that many of the fixed assets (equipment and inventory, for example) are sold at less than book value to quickly raise cash. Therefore, a family business's liquidation value is typically lower than that same business's book value, the latter of which usually applies to a healthy, ongoing business operation.

Getting to the bottom line — with expert help

TIP

So, how do you put all these calculations together and come up with the value of your family business? We recommend that you get an independent third-party opinion.

You can get an independent valuation opinion in a few different ways. You can find software that is specifically designed to provide a valuation for your business. By using your business's various financial benchmarks we discuss earlier in this chapter, the software produces its opinion (actually, the opinion of the company who produces the software) of your business's valuation. Often, however, you may prefer to actually hire someone who specializes in valuing businesses — specifically, a *business valuator.*

A business valuator determines your business's worth. The business valuator processes the relevant financial information to obtain a value. They can also take into account things that would impact your business value that software may overlook. Is your business in a growing segment of the market, or is your business in a dying industry? Is there something unique about your business that creates additional value? Welcome to the concept of *goodwill,* but not the secondhand thrift store (see the nearby sidebar).

If you determine that you need an independent person to value your family business, where do you find one? You may use your accountant — especially a Certified Public Accountant (CPA) — because your accountant already knows how your business operates. However, you may want to find someone who has a highly specialized background in business valuation.

DON'T FORGET GOODWILL

A business valuator may give some value for your business's reputation and its built-up perception in your industry. This so-called *goodwill* is subjective and is additional value beyond your business's other assets. If, for example, you, your sister, and your brother are co-owners of a moderately sized chain of retail stores that has been a landmark in your city for more than 30 years, and if business is still going strong, your business value may be pumped up by an additional amount for goodwill.

You can find CPAs who have received specific training through intense study, including a five-day training program and comprehensive exam, for the valuation of closely held businesses. These Certified Valuation Analysts (CVAs) are trained to apply a consistent standard of valuation for a closely held business. To find a CVA in your area, you can go to the National Association of Certified Valuators and Analysts website at `www.nacva.com`.

Alternatively, you can engage a CPA who also has a designation as Accredited in Business Valuation (ABV). Though not as touted as a CVA, a CPA with an ABV (talk about acronym overload!) has also received specialized training in business valuation.

Finally, you can also look to a business broker who specializes in selling businesses and determining value.

TIP

Your search for a business valuator may require you to look outside your geographical area. For example, if your family business specializes in manufacturing widgets, but the local business valuators you contact focus primarily on retail family businesses, you may want to search for a business valuator with manufacturing business valuation experience.

After you've done all your legwork — getting all your business's financial details together, informing your business valuator of the details of ownership structure (partnership, corporation, and so on) and the percentage of your ownership — your business valuator can tell you how much your business is worth. You can then factor this result into how your overall estate plan relates to your business plan.

TIP

If you need to determine the value of your business for any reason — succession, business sale, estate planning — this is not the time to pinch pennies. You need an accurate valuation of your business. If you only need a quick estimate, you can obtain a business valuation instead of a deep-dive business appraisal. Whatever the cost turns out to be, it's one of those costs of being in business.

Dealing with Business Evolution: Stuff Darwin Never Imagined

Another important challenge you must undertake is deciding how your business will evolve, when your business will evolve, and how that evolution will affect your estate's value and the estates of any other co-owners.

TIP

But you may have even more challenges. Scan the following list of possible business evolutionary twists. If any of them resonate with you (like setting off alarm bells), make a note to raise these topics with your co-owners and your professional advisers. Specifically:

- What happens if you own and operate a one-person sole-ownership company, and you want your oldest son to take over the business from you, but he doesn't want to? Do you instead turn to another child, or maybe a nephew or niece? If so, do you adjust your estate plan to make up for your oldest son not having the business and provide them with other assets in your estate instead?
- What if your oldest son *does* want to take over your business from you, but you feel that he's not qualified? The good news (at least from a business continuity standpoint) is that your only daughter is a business whiz and you're confident that she'll grow the business far beyond what you ever could achieve. Whether you give or sell the business to your daughter, what (if anything) do you do about your oldest son in terms of your estate plan to make up for his not getting the business? Do you retain a small ownership of the business after your daughter takes over because you think that will turn into a great investment? If you do retain a small ownership, should you change the sole-ownership structure to a partnership or a limited partnership with you as a limited partner, or perhaps a corporation? Do you expose your estate by retaining an ownership stake after your daughter takes over, just in case your opinion of her business skills is (to put it delicately) overrated? And will your oldest son and daughter ever speak to each other again?
- What happens if you and your brother are in business together in a partnership, and for whatever reason, the two of you become estranged? Does one of you buy the other out, or do you both sell the business and get out before you run the business — and your respective estates — into the ground?
- What if you and three of your siblings are actually getting along fairly well in your family business partnership, but suddenly one of your brothers needs to raise a large amount of cash for some personal matters in his family? He really doesn't want to sell out, and nobody else wants him to sell out, either. Do you adjust the ownership structure of the business, either temporarily or permanently? How is everyone else's estate affected by any temporary or permanent changes?
- What happens if one partner in a family business has financial or legal problems? As we discuss earlier in this chapter, one of the chief risks to many family businesses is exposure to liability. But suppose you have adequate insurance, or that your family business is structured as a corporation, so you and the other owners have limited liability. Your business and your respective estates may still be at risk if, for example, the family member with the problems is really the brains of the operation and is now either distracted or totally absent from running the business.

Estate taxes may be a significant challenge to keeping a business viable, as we discuss in the Chapter 16, depending on how much of the business is in cash or is liquid enough to pay any taxes.

WARNING

Make sure that you examine and understand the impact of your decisions on everyone involved in the family business. These decisions can't be made in a vacuum because they have a potential impact on your estate planning.

In Chapter 16, we discuss some specific strategies and tactics you can use to mitigate many of these family business challenges and help protect your estate.

IN THIS CHAPTER

» Creating buy-sell agreements

» Shifting your business ownership to another family member

» Figuring out estate-tax considerations for family businesses

Chapter 16

Transferring Ownership and Paying Estate Taxes in a Family Business

If you own 500 shares of stock in Home Depot and decide to sell part or all your stock, doing so is a breeze. You go online or call your broker and — presto — you no longer own those shares! At tax time, you figure your gain or loss and settle up with Uncle Sam. Easy-peasy.

But when you sell or give away your ownership in a family business, the process is much more complicated than buying or selling publicly traded stock. Yes, we agree with you that a family enterprise should be easier to navigate than a deal on the Big Board, but that's what makes family-business life "interesting." To complicate matters even more, the transfer of ownership in your family business can take place *after* you die, meaning that estate-tax considerations come into play. Even in death, the family business continues on. But this can present many challenges to the business from an estate-planning perspective.

In this chapter, we present you with a concise overview of the family-business equivalent of selling your 500 shares of Home Depot stock. We explain how to get out of the business (whether you're alive or dead), as well as the estate-tax consequences — and a few tax breaks to help save your estate some money.

Exploring the Ins and Outs of Buy–Sell Agreements

The name says it all. A *buy–sell agreement* is (get ready for a big bold statement of the obvious) an agreement in which you decide how you'll sell your ownership in a family business and who the buyer will be. A buy–sell agreement not only helps to protect your business by keeping it intact and operating, but also helps protect your estate — and the estates of family members with whom you're in business — because your estates are likely to be closely intertwined with, and dependent on the success of, your business.

WARNING

Take note of this very important point about a buy–sell agreement: Create the agreement long before you actually plan to sell your family business ownership. How long? We recommend that a buy–sell agreement be in place as part of your initial business documentation (upon the formation of the family business). If you have an existing family business and you currently don't have a buy–sell agreement in place, there's no time like the present! Think of a buy–sell agreement as "an agreement on standby" that suddenly comes to life when some type of triggering event occurs.

A *triggering event* is (and here's one more statement of the obvious) some event that sets off the need for the buy–sell agreement to wake up from standby and guide you in the sale of your family business ownership. The buy–sell agreement may be triggered

- If you become disabled (long enough to prevent you from running the business for an extended period of time or maybe even permanently)
- When you die
- If you decide to retire
- If you decide to sell for any reason
- If you divorce
- If you file for bankruptcy
- If you lose a professional license that's required to operate the business
- If you receive an offer by a third party to buy the business from you

Notice how the various triggering events include a mixture of items that relate to you personally (such as becoming disabled or when you die), while others relate primarily to the business (losing your professional license or receiving an offer to buy you out). Because your personal and professional lives and fortunes are usually so intertwined with a family business, consider triggering events from both your personal and business perspectives when planning a buy–sell agreement.

WARNING

In the preceding list, you may only be able to predict and plan one of the triggering events years in advance — retirement. A few other triggering events, such as divorce or bankruptcy, may be anticipated (that is, you realize that you have marital problems or that your personal finances are on a downward spiral), but very often your warning period is so short that you won't be able to seek out favorable terms to sell your business ownership, resulting in your family business collapsing, being sold for far less than it's worth, or (at best) being seriously disrupted. Finally, other triggering events can happen with no warning at all, such as your death or disability.

REMEMBER

Therefore, even if you're immersed in running and growing your family business — and, consequently, your estate's value — look ahead to when you'll no longer want to or be able to be involved in your family business, and plan now for what will happen then. Trust us, that day will come, sooner or later, and you may as well be prepared.

REMEMBER

Your estate plan is about protection and control, and your family business buy–sell agreement does both of these things for you and your estate.

Looking at a typical buy–sell agreement

Buy–sell agreements are particularly appropriate when you're involved in a business with other family members. The typical buy–sell agreement may specify something like the following:

- If you die while you're still actively involved in the business, your estate must sell your share of the business to the other family members in the business who survive you, according to some predetermined "sales rules." For example, your ownership share may be split equally among all the surviving family business owners, or perhaps only one of your relatives/partners may purchase your shares.
- If you retire from the business, you must first offer to sell your ownership stake to the other family members in the business, again in some way that you all see fit (equal split, only one person buying you out, or some other type of arrangement). If, however, your relatives/partners elect not to buy you out, you're then free to sell your ownership to some other third party, who may or may not be a relative.

WARNING

No matter how close you are to other family members, family businesses can get ugly — and ugly fast — because disputes arise between family members. The buy–sell agreement protects all family members involved in the business, so everyone has a road map of what happens to the business in case any of the aforementioned triggering events occur.

In both of the sample triggering events and terms we describe, the buy–sell agreement clearly specifies the purchase price of your ownership stake. In Chapter 15, we discuss various methods used to calculate the value of your ownership portion of a family business and recommend that you seek professional assistance from a business valuator to help establish an accurate valuation.

TIP

Many people were brought up not to discuss money with others, including family members, but there are exceptions to that rule. Many family business issues arise because of monetary disputes over the business valuation. Suppose your cousin Melvin has a 30 percent interest in the family business and strongly believes (in spite of financial facts) that the business is worth five times its true value. This can cause a serious family rift if he holds on to that belief, which in turn could affect the business operations. When you have an accurate valuation, this information should be shared with other involved family members (even those who have a minority interest in the family business).

Because a buy–sell agreement may not be triggered for many years after it's created, the agreement should specify a *method* for determining the sale price rather than an actual sale price. For example, the buy–sell agreement may specify that a particular industry-specific *sales multiple* (see Chapter 15) be used, or the agreement may simply state that the business will hire a business valuator who will value the business at the time of sale and, based on the results of the valuation, establish an appropriate sale price.

WARNING

A future (possibly many years down the road) triggering event of a buy–sell agreement necessitates, at minimum, an annual review of the agreement. Beyond the changes in valuation over time (hopefully increasing and not decreasing!), circumstances may change that would alter the terms of the agreement. For example, your nephew who was in high school when the buy–sell agreement was originally created may decide, after earning his MBA, that the family business is the perfect fit for his career, and you may concur. But if the buy–sell agreement hasn't been updated, a triggering event could lead to a forced sale to a third party instead of a provision allowing your nephew to buy out the business and keep it "in the family," which may be exactly what you want to happen.

You may, however, include a specific purchase price in the buy–sell agreement, or perhaps a table of purchase prices for each of the next 50 years. Basically, you and the family members with whom you're in business can put whatever you all agree to in a buy–sell agreement, including some fixed sale price.

WARNING

If your business and family relationships are fairly strained, a predetermined fixed price that one or more parties now feels is unfair could be the cause for a protracted (and expensive) legal battle as everyone wrangles over trying to break the agreement and reset the sale price. So be careful setting a predetermined fixed valuation too far into the future. A better approach would be to update the valuation every couple of years (or more frequently if warranted) to reflect changes in your industry and changing macroeconomic conditions.

Funding the buy–sell agreement

Suppose you're in business with you brother as equal partners, and you've grown your small manufacturing company to be very successful — worth $4 million based on a recent independent business valuation. You have no intention of retiring — you want to keep working as long as you're healthy or until you die.

You and your brother put a simple buy–sell agreement in place, agreeing that when the first of you dies, the survivor will have the right to buy out the other's (technically, the decedent's) ownership, based on a revised business valuation that the survivor will obtain within 30 days after the first of you dies.

If you and your brother have been stashing away cash for years, quite possibly you have $2 million handy that you can use to buy out the other if the triggering event occurs. But suppose you don't quite have $2 million available in your bank accounts? If your brother dies first, how would you come up with the money to buy out his share from his estate?

You could, of course, try to take out a loan using your business assets as collateral. But suppose that for business or personal circumstances, taking on additional debt makes you queasy. After all, if you borrow a large amount of money, you're adding a significant loan to your financial picture and affecting your estate. What if the business suddenly starts doing poorly? You may still be on the hook for the loans (depending on the legal structure of your business, as we discuss in Chapter 15), which could dramatically reduce or even wipe out your estate.

A better strategy that is commonly used is to use life insurance to provide the cash to buy each other out. We know, yet more insurance-related stuff for your estate, but hear us out. In Chapter 17, we discuss how you can use certain types of life insurance as part of business-related estate planning. One type is a *first-to-die* life insurance policy, in which (in this example, and to oversimplify a bit) your brother's estate receives a $2 million death benefit upon his death, and in turn, you take over his ownership of your business. Alternatively, if you were to die before your brother does, your estate receives the $2 million death benefit and your brother takes over sole ownership of the business. Think of this beyond the traditional reason to have life insurance; think of it as a future financial lifeline for your family business.

TIP

Life insurance can allow you and family members with whom you're in business to actually fund a buy–sell agreement and to execute that agreement in one of several forms, including those we describe in the next section. So, beyond any personal insurance that you have, such as life, disability, health, and so on (see Chapter 17), make sure that you look into business-oriented life insurance if you're involved in any kind of business, particularly a family business.

Selecting the right form of buy–sell agreement

Buy–sell agreements come in various flavors, and one may be more tempting than another. (And no, chocolate is not one of the flavor choices!) This section presents a brief overview of:

- Cross-purchase agreements
- Entity-purchase agreements
- No-sell buy–sell agreements

Cross-purchase agreements

If a buy–sell agreement is a *cross-purchase agreement,* each owner purchases an insurance policy on the other owner(s) so that a "crossover" in policies exists for each owner. Each owner owns and is a beneficiary of an insurance policy on the life of the other owner(s). Upon the death of any owner, the remaining owner(s) buy the now-deceased owner's interest in the business with the benefits paid by the insurance policy.

TIP

A cross-purchase agreement can also be used in other circumstances such as a partner retiring, a partner suffering a disability, or some other triggering event. The point of the agreement remains the same: It allows the remaining business partner(s) to purchase the partner's interest in the business and protect the remaining partners' interest.

REMEMBER

Protection and control are basic principles of estate planning, and these various forms of buy–sell agreements enable both protection and control for the family business.

The advantages of a cross-purchase agreement include the following:

- Insurance policy death benefit amounts are usually free of income tax (but check with your accounting professional because this can vary).
- Business creditors can't touch insurance policy proceeds because the business doesn't own the policy.
- In some instances, overall taxation may be more favorable than with an entity purchase (see "Entity-purchase agreements," later in this chapter).

But of course, with advantages also come some disadvantages:

- Administrative expenses increase and are more complex when more than a few family members are involved in the business, because each has to have an insurance policy on all other owners. (We cover how to get around this disadvantage later in this chapter.)
- The costs to policy owners vary because premiums are higher or lower based on the insured's age. For example, a younger owner pays higher premiums for a life insurance policy on an older owner due to insurance premiums based on age, while the older owner pays less for the younger owner's insurance policy. Therefore, you often have unequal (and inequitable) costs to each owner.

You can use a type of cross-purchase agreement that eliminates the inherent disadvantage if the business has more than two owners. For example, if the business is a corporation with six stockholders, 30 individual life insurance policies are required to fund a cross-purchase agreement! (Here's the math: Each stockholder has five individual life insurance policies on the other five stockholders, so six stockholders multiplied by five policies each is 30.) All these policies result in a higher cost than one larger policy, not to mention potential confusion. And you may have potential problems if one of the owners forgets to pay the premiums on one or more of the policies and the policy lapses.

TIP

To get around this problem, a *trusteed cross-purchase agreement* enables the corporation to set up a trust that owns one insurance policy on each stockholder. The corporation pays the insurance premium and then charges each shareholder's salary or dividend account their percentage share of ownership for the paid premium. When a stockholder dies, the insurance proceeds go to the trustee in exchange for the sale of the deceased's stock to the other stockholders. Typically, the remaining stockholders have the added benefit of a step-up cost basis, which means the business market value is "stepped up" to the date the revised shares are received rather than the value when the family shares were purchased.

Entity-purchase agreements

With an *entity-purchase agreement*, the company, rather than the owners individually, purchase disability and/or life insurance on each partner. The business has an agreement with each owner that in the event of death or disability, the company purchases the owner's interest, and each remaining owner's interest in the business increases because now the company has one less owner. The insurance policy's proceeds purchase the owner's interest.

Advantages of the entity-purchase form of a buy–sell agreement include the following:

- The company avoids several extra steps because it's buying the policies rather than all the individual owners doing so.
- The company pays the premium costs so owners themselves aren't subject to different premium costs based on age. Still, the company premium payments on the various owners may still be unequal based on each owner's age — but at least the company is absorbing those costs.

WARNING

The disadvantages of entity purchase agreements include the following:

- Creditors may make claims against the proceeds of the insurance policies because the policies are owned by the business, not by the owners. So, if your business owes any creditors, and they try to go after the money from those insurance proceeds, your entire buyout plan can go down the drain.
- Insurance policy proceeds may amplify estate taxes by increasing the value of the business if the death benefits are added back into the business. (See our discussion in Chapters 14 and 17 about the life insurance estate-tax trap and ways you can get around that problem.)
- The company is legally obligated to buy the partner's share of the business, so it isn't possible to sell the share to another interested party (which may in the present be the prudent thing to do).

No-sell buy–sell agreements (yes, you read that right)

A *no-sell buy–sell agreement* (or is that the "she sells seashells" agreement?) keeps the remaining business owner(s) in control of the business but provides the deceased owner's family with an interest in the business — meaning a stream of income, they hope.

Other advantages of the no-sell agreement include the following:

- The business can, on its tax return, deduct the insurance premiums paid as compensation to the owners.
- The deceased owner's family is still part of the business and can be part of its success (and their estates can correspondingly grow as the business continues to grow).

The chief disadvantage of a no-sell buy–sell agreement is that while the surviving owner(s) control and manage the business, a portion of the business's ownership is in other people's hands, which can upset the apple cart of the business and how decisions are made, especially in a family business where underlying subjective feelings are present. In a close family, this nonmanagement ownership may not be a problem. For example, if you're in business with your three sisters and one dies, you and your other surviving sisters may have no problems with your now-deceased sister's surviving spouse and children having an ownership stake in the business. However, families with somewhat more adversarial and less congenial relationships may prefer (in psychological terms) closure to the ownership process if one of the owners dies, and no-sell buy–sell agreements may not be the best course.

TIP

If a no-sell buy–sell sounds like something you want to explore, talk with your attorney. The deal involves technical stuff like voting and nonvoting shares that a legal eagle should explain in detail and tailor the most appropriate form of a buy–sell agreement to your particular family business circumstances.

Thinking through your buy–sell choices

With so many options available for buy–sell agreements, we run through a list of what-if scenarios to make sure that your specific buy–sell agreement achieves what you intend, not only for business purposes but also for your estate plan (as well as the estate plans of other family members involved in your business).

REMEMBER

Buy–sell agreements are not just agreements that address your family business. Instead, they're legal documents that impact more than your business and how partner triggering events may alter the ownership of the business. They need to be viewed through the larger lens of your estate plan and the impact it has on the estate plans of all family members. It's important to keep in mind that estate plans vary, even among family members, so these agreements need to have the appropriate due diligence done to see their potential future impact on *all* family members.

The following isn't an all-inclusive checklist, but it's intended to provide you with some items to think about when you're contemplating entering into a buy–sell agreement:

- Decide if the buy–sell agreement applies just to current owners and shareholders, or to future ones as well — for example, if your oldest son and your brother's oldest daughter plan to join the business in a couple years, after they graduate from college. The next generation of family members needs to be kept in mind when planning to have a buy–sell agreement.
- Decide if, upon the death of an owner, the company automatically buys out their interest or if the deceased owner's family (spouse and children, typically) has an opportunity to do so. Making this decision helps determine what type of buy–sell agreement you want to have. Keep in mind the business skill set (or lack thereof) of a deceased owner's family members when making this decision. This should not be an emotional decision ("They would want their kids to be in the business") but should be grounded in an honest assessment of what they can, or cannot, bring to the family business.
- Determine the time period in which to pay a shareholder or that person's estate in the event of a triggering event (Within 90 days of someone dying? Within six months of becoming disabled? Over the next five years?). If you're going to rely on payment from a life insurance policy (as discussed earlier in the chapter), make sure you read the fine print in the policy as to the timing of the payout. The last thing you want is to be required to pay out a large sum of money (or even a smaller sum) and not have the funding mechanism payout in line with the timeline in your buy–sell agreement.
- When you're looking at the final agreement, clearly state that your buy–sell agreement is the most current (and make sure the agreement is dated so it's clear as to when all parties entered into the agreement) and supersedes all other existing agreements regarding stock purchases among owners and shareholders. (If this scenario sounds familiar, you're right. You take the same step in your will to clearly state that your particular will is the most current one and supersedes all others — see Chapter 3.)

Transferring Ownership to a Family Member

You may want to transfer ownership of a family business to your children while you're still alive and maybe even still actively involved in the business, or as part of your estate. If you don't have any family members with whom you're currently in business, you don't have to worry about buy–sell agreements with your brother/partner, for example. Your business is your own, and you're free to do with its ownership what you want.

Sometimes, transferring ownership of your family business is cause for you to change the form of ownership. If your business is a sole ownership, for example, transferring ownership to your three children requires the business to be a partnership, corporation, or one of the other multiple-owner forms of business we discuss in Chapter 15. Always ask yourself what will change if you transfer ownership interest to other family members *before* you do the transfer.

TECHNICAL STUFF

Sometimes, transferring ownership and changing the ownership form can play into your estate plan. For example, if you convert your business to a corporation, you can do what is known as a *preferred stock recapitalization.* Think of recapitalization as beginning your business over again by changing how the business is set up. You can set up different ownership classes within the corporation. Voting shares anyone?

When your business is recapitalized, you've created different classes of stock. Initially, you still own 100 percent of all the stock. But you can now begin to sell or gift the different classes of stock to family members, which enables you to begin the transfer of your business as you want while still achieving your goals.

REMEMBER

If you gift your ownership interest over a period of years, you can take advantage of the gift tax annual exclusion we discuss in Chapter 11. As you gift, your estate's value decreases and the gifts you give are tax-free to the extent that they stay under the annual exclusion. But remember: These exclusions typically change annually, so don't blindly provide ownership gifts without first verifying the current exclusion amount.

Suppose that to protect your estate, you still want to retain control of your business, even as you begin to give away portions of ownership as gifts. Your corporation can have *voting stock* (stock in a corporation that enables you to make the important decisions regarding how the business is managed and operated). Your family members, however, receive no-voting stock. You can still make the important strategic decisions for the business while you slowly bring other family members into the business operations. Voting shares are a prime example of providing protection and control in all forms of your estate plan.

TECHNICAL STUFF

You may also want to receive income from the business, even after you transfer much or all of the ownership to other family members and perhaps head off into retirement. You can set up your preferred stock to receive dividends, so you (and your estate) can still benefit financially from the business that you built. Talk to your attorney about how to do this.

Identifying Estate-Tax Considerations for Family Businesses

Estate taxes can cause the death (pun intended) of a family business if an owner dies, even if other family members who are also owners keep the business going and even if everyone has put solid buy–sell agreements or family ownership transfer plans in place.

What's the problem? Sometimes a wealthy person may actually have access to very little cash because most of their property (and, therefore, their estate) is in *illiquid assets,* such as real estate and other property that can't easily be turned into cash. Or, even if you or your estate *can* turn some of that property into cash, you would have to sell some property to make the cash available. In short, no matter how wealthy a person — or business — looks on paper, that person or business may actually be cash poor.

Assume that, for example, you're in business with your brother and two sisters and your business is worth $36 million. Also suppose that outside of the portion of the business you own (25 percent because all four are equal co-owners), the rest of your estate consists of your house and some stock investments that haven't been doing very well lately. You have several bank accounts and certificates with about $50,000 in total, so for most routine expenses you can get your hands on a decent amount of cash if you need it.

But now you die unexpectedly, and your estate needs to be settled. Suppose your estate's value totals just around $11 million — your $9 million that represents your portion of the family business, plus another $2 million in your house, bank accounts, collectibles, and other property. Assume also that you die in 2026 when the federal estate-tax exemption amount is anticipated to be approximately $6.4 million (see Chapter 13).

Finally, assume that you aren't currently married and, therefore, have no spouse to whom you can leave your estate and take advantage of the marital deduction.

Uh-oh! Your estate has to come up with a significant amount of cash to pay the federal estate taxes that it owes! Furthermore, if you lived in a state with an estate or inheritance tax, your estate has to pay even more money.

But what's the problem? After all, if you have an estate valued at $11 million, why can't the appropriate amount of money be "subtracted" from the property in the estate to pay the taxes, and then whatever is left over, goes to your children or whomever you want to leave property in your estate?

Because your estate doesn't have enough cash! For argument's sake, we assume that the total bill for federal and state estate taxes comes to almost $3 million. You don't have that amount of cash right now, and unless you sell your share of the business before you die (which, for purposes of this example, you haven't, which is why your estate has a problem), the money just isn't there to pay the taxes.

By now, you hopefully see the problem: The bill for estate-related taxes (federal and, if applicable, state) is based on the tax tables and rates, exemption amounts, and other factors that are in effect the year you die. But if you're still actively involved in the family business and if most of your estate's wealth is tied up in that business, then you and your family members with whom you're in business have a big problem on your hands. Where will the money come from to pay those taxes?

REMEMBER

You can fund a buy–sell agreement with life insurance to help with a smooth transition of your business ownership (see "Exploring the Ins and Outs of Buy–Sell Agreements," earlier in this chapter).

But even with a well-thought-out buy–sell agreement to smooth the transition and make the necessary cash available for the actual buyout, you still have estate-tax issues to deal with if your estate is valuable enough to be in the estate-tax zone.

We have some good news for you, though! You have some tax breaks and special tax treatment options available to you if you're an owner of a family business. We describe these breaks and special treatments in the following section.

As we discuss in Chapter 15, the IRS has some very specific rules and laws that determine whether your business is really a family business and can qualify for the breaks. Make sure that you receive a clear and precise ruling from your estate-planning team — particularly your accountant and attorney — that lets you know whether you and your business can take advantage of this special treatment when your estate is settled.

The most significant tax breaks for family businesses are as follows:

- The qualified family-owned business (QFOB) exemption
- Spreading out estate-tax payments over several years
- Tax breaks on the value of business real estate
- Giving away minority interests in your business as gifts and using a *valuation discount* to reduce the value of your business for estate purposes

Don't crowd me — spread out!

Current tax law allows your estate to "spread out" — or delay — having to start paying federal estate taxes for five years after your death and then to pay off any estate taxes over ten years, in equal installment payments. So, this IRS code (referred to as the "6166 extension") allows you to spread out annual payments over a total of 15 years as opposed to having to pay all estate taxes within nine months of your death. With that kind of time, hopefully your estate can raise enough cash through business operations or other means to prevent having to sell off crucial business assets to pay estate taxes — paying the taxman but possibly killing the business in the process. You'll have to pay interest on the unpaid estate taxes but that's better than having to come up with the full estate-tax amount owed.

TECHNICAL STUFF

To take advantage of delayed and spread out payments, your family business must be at least a certain portion of your estate — under current tax law, at least 50 percent of your taxable estate or 35 percent of your total estate. Additionally, if the business is a partnership or corporation, you must own 20 percent of the partnership or 20 percent of the voting shares, respectively. (See our discussion in Chapter 13 about the difference between taxable estate and total estate numbers.)

Valuing real estate for estate-tax purposes

If you're a farmer or you have a small factory or industrial plant, you may have special below-market valuations on your land and real estate for property taxes. These valuations are based on how you're using your property versus other ways the land could be used, such as a residential subdivision. For example, if your family business is a 250-acre farm, your land, barns, and other buildings are probably zoned and valued at some sort of agricultural rates that (depending on where you live) are significantly less valuable for tax purposes than 250 acres of farmland that is just waiting for a real estate developer to show up with the bulldozers.

But aside from property-tax breaks, you may also have estate-tax breaks on your real property. Current tax law allows you to value land you use for your farm or business according to how you currently use it rather than how it may be used — again, for example, developed and turned into a residential subdivision.

As with other tax laws and rules that apply to family-owned businesses, you find several restrictions that determine whether you can take advantage of this tax break. If you can, limitations also restrict how much you can reduce your estate taxes by including: a minimum percentage of the value of the real estate to your estate's total value, another minimum percentage of the value of the business to your overall estate, how many years you've used the real estate in business, and so on. Here again, it's advisable to check with a professional (a real estate appraiser would be a good candidate) on the property valuations under different use scenarios for the property. You need to document the various use valuations of the property.

TIP

Rather than list all the rules, we suggest you check with your accountant. They can tell you exactly how much of a tax break — if any — you can plan on receiving. With this knowledge, you can do your estate planning and your business planning as accurately as possible.

Shopping for more discounts at the family-business store

Earlier in this chapter, we discuss how you can transfer ownership in part or in full to other family members, a piece at a time, by giving away minority ownership interest. Quite often, you can keep these individual gifts below the annual exclusion radar for gift taxes. Even if you don't, your gifts may be tax-free if the combined amount of gifts and what's left in your estate when you die doesn't exceed the exemption amount in the year you die.

But beyond the gift-based strategy of reducing your estate gradually, you may also take advantage of some additional discounts that further reduce your family business's value, at least for estate-tax purposes.

TECHNICAL STUFF

When several family members own a minority interest in a family business and have restrictions on how they may sell their ownership (only to other members who already have stock in the family business, for example), then a *valuation discount* is applied to the family business's overall value. Basically, you can declare that the business's overall value is less than it would be because of the fragmented ownership picture (lots of people, restrictions on selling, lack of marketability, lack of control [finally, we found something in estate planning where not having control is good!], and so on). If you tried to sell the business for what it may otherwise be worth according to the valuation methods we discuss in Chapter 15 (book value, sales multiple, and so forth), you won't be able to get what the business is worth.

As a result, some discount percentage is applied to the overall business value to "mark down" the value of everyone's shares, at least on paper. These discount percentages typically range between 10 percent and 40 percent, so they can potentially be a significant savings to you. How? Not only is your share of the business suddenly worth less than it otherwise may be — and for estate-tax purposes, "less" is good! — but as you make any future gifts to other family members, the valuation of those gifts is also deemed to be lower (for gift-tax purposes) than if the valuation discount weren't in effect.

Essentially, you use the valuation discount to reduce your business's value on paper. Therefore, you can reduce applicable estate-related gift taxes — federal estate taxes, gift taxes, and any state taxes — while you're in the process of transferring ownership of part or all of your family business to other family members.

WARNING

The IRS allows valuation discounts, but it isn't happy about them! If you need to file a gift-tax return (Form 709; see Chapter 11), you find a question (currently at the beginning of Schedule A of Form 709) asking you if any gifts you're declaring reflect a valuation discount. If so, you need to provide more information and answer several questions.

Make sure that whoever you may consult for this purpose — your accountant, an outside business valuator, or perhaps both of them working together — advises you on the percentage number to use for any valuation discount you claim. Make sure you also receive a clearly written explanation of the rationale and justification for the percentage you're using. You can't just randomly self-determine a valuation discount; you need backup on the rationale for it. Trust us: The IRS will want to know why you used the percentage you used. If the IRS isn't satisfied with your explanation, it'll likely challenge the valuation discount and the value and tax liability of your gifts!

6 Crafting a Comprehensive Estate Plan

IN THIS PART . . .

Ensure that insurance helps you get what you want out of your estate planning.

Stay on top of your retirement stash to meet your estate-planning needs.

Expect the unexpected through your estate plan.

IN THIS CHAPTER

» **Understanding how insurance can protect your estate**

» **Looking at common types of insurance**

» **Paying special attention to your life insurance options**

» **Figuring out the tax implications of life insurance**

» **Knowing the right questions to ask about insurance**

Chapter 17
Factoring Insurance into Your Estate Plan

In this book, we introduce the four members of your estate-planning team — financial planning adviser, accountant, insurance agent, and attorney — and discuss how important each professional is to your estate planning.

In this chapter, we focus on insurance. We look at how various types of insurance factor into your estate plan and how your insurance agent fits into the planning process. And here's a heads-up: We take a broader perspective on insurance than many other estate-planning books, going beyond simply basic life insurance. We think that health, disability, long-term care, and auto insurance, for example, all are part of the picture, and we explain why.

For many people, an insurance agent provides this holistic view and can put together a comprehensive package of insurance plans to meet your specific needs. But many other people today bypass the agent and go directly to insurance companies by telephone and especially the Internet. This chapter also prepares you to deal effectively with customer service representatives who may not be familiar with all the important estate-planning details you need to know, such as ways to craft a life insurance policy to reduce or eliminate federal estate taxes. Our advice: If you do business with your insurance company without dealing with an agent, make sure you bounce your ideas off your financial planning adviser. (Please see our discussion in Chapter 1 about selecting that key adviser.)

Using Insurance to Protect Your Assets

Protection!

We say it again: Protection!

After all, as we mention at the very beginning of Chapter 1, estate planning is all about protection and control. When it comes to protection, make sure you have a comprehensive insurance strategy.

Insurance provides you with protection against various situations that can dramatically impact your estate, such as the following:

- Unexpected — and unexpectedly high — expenses, such as medical bills or long-term nursing home or home health care that can cost you a lot of money and even force you to sell some of your assets — such as your home — to pay those expenses
- Dying before your time and leaving behind family (such as your spouse and children) or even a charity that has depended on your gifts and has anticipated future continuance of those gifts
- Becoming seriously disabled and unable to earn an income
- Lawsuits over an automobile accident, an injury that occurred on your property, or just about anything else where, if you lose, you may lose a lot

You may have heard the saying "Only insure what you can't afford to lose," which is certainly sound advice when you decide on coverage for your automobile insurance and health insurance. Don't allow anyone — even your insurance agent — to talk you into buying more coverage than you need.

But with estate planning, modify the statement to "Make sure you insure what you can't afford to lose!" Look at the four items listed earlier in this section. Do you want to see most or all of your lifetime savings go to pay for medical coverage or nursing-home care? Do you want an automobile accident to turn into a situation where you get sued and have to give up a significant portion of those same lifetime savings?

Insurance relates to your estate plan in three possible ways:

- Protecting assets that are currently part of your estate from being unexpectedly taken away for one of several reasons, such as a lawsuit against you or unexpected costs due to disability or nursing-home care
- Protecting assets that aren't currently part of your estate but will almost certainly be part of your estate in the future
- Supplementing the assets that are currently part of your estate by providing additional cash for one or more beneficiaries as part of your estate plan

We discuss each of the preceding three strategies for linking insurance to your estate plan in this chapter. ***Note:*** However, for your particular circumstances, not all three may apply. For example, you may only be concerned about the first item — basic protection for assets you have. Alternatively (and very likely), all three can be of equal interest and concern to you.

Protecting what you've already got

As we discuss earlier in this chapter, people buy insurance for protection. In Chapter 2, we discuss how you need to conduct a thorough inventory to figure out your estate's value. Suppose, for example, you conduct just such an inventory and find out that your estate is worth $950,000 after any remaining debts and liabilities. You then decide how much to leave behind to take care of your spouse if you die first, as well as what you want to leave to your children and your grandchildren — and you decide that $950,000 is more than enough. So, as Hugh Jackman or Chris Hemsworth might put it, "No worries then, mate!"

Not quite! Suppose you're involved in an automobile collision that's your fault, and you seriously injure one or more people in the other vehicle. You know that you'll be sued. (You've seen those commercials for litigation attorneys that begin with "Have you been injured in an automobile accident?")

WARNING

Without adequate liability coverage in your automobile insurance policy or other liability-related insurance (like umbrella insurance, which we discuss later), you may find your $950,000 estate worth far less after a legal judgment against you or an out-of-court settlement. Indeed, your entire estate can even be wiped out!

Now you may be thinking, "I'm a safe driver" or "I don't even own a car!" Are you safe from your estate being drastically diminished or wiped out? Sorry, the answer is "no!" Without sufficient insurance, a serious illness or automobile accident can cause you to lose some or all of your estate.

WARNING

When shopping for automobile insurance, remember the old adage "You get what you pay for." Players in the insurance industry have *huge* marketing budgets that promote the "big, big" savings on your auto insurance when you sign up. But don't be lured into discounted car insurance based solely on saving money. Often, some heavily discounted premium cost equates to your state's minimum insurance requirements. What's the problem then? Well, these minimum insurance requirements often aren't sufficient to protect you when you have accumulated assets and may put your assets at risk. The savings in the premium cost is not worth putting your assets — and perhaps much or even all of your estate — at risk, especially without an umbrella policy (which we discuss later in this chapter).

Insurance and estate planning go hand in hand. Insurance covers you against various forms of liability and unexpectedly high expenses. Later in this chapter, we discuss different types of insurance that you need to check into to protect your estate.

TECHNICAL STUFF

Even if you declare bankruptcy and walk away from crushing debts and liabilities, if you own nonexempt assets under the bankruptcy laws, you may have to give up almost all your assets as part of the bankruptcy proceedings. The rules vary — you may be able to keep your home through your state's homestead exemption that protects a specific dollar amount of home equity from creditors, for example — but essentially, bankruptcy allows you to start over with many of your debts and liabilities behind you. ***Note:*** You also have to start over with your estate plan because you probably lost most, if not all, of your estate during the bankruptcy proceedings. If you file for bankruptcy, you need to revisit any estate-planning strategies.

Therefore, even though bankruptcy may help you get back on your feet again after a severe financial setback, for estate-planning purposes, you're basically back at square one. This is one of the dark sides of bankruptcy: the "financial restart" you now have actually wipes out your past estate planning! The moral of the story: Make sure you have adequate protection-oriented insurance so you don't find yourself in such a predicament!

Insuring the future: Protecting what you hope to acquire

You need to include insurance in your estate planning to protect what you don't have right now but expect to have in the future. No, we're not engaging in a bit of double-talk. Think about the basics of life insurance (which we discuss in more detail shortly). You pay a little money now so just in case you die before your time, your spouse, children, or other beneficiaries receive a larger amount of money.

Your life insurance agent can help you fill out worksheets to figure out how much "future-income insurance" you need, but here are a couple of general guidelines to help you begin working with your insurance agent:

- Have enough life insurance to cover a mortgage balance on your house. If you were to die tomorrow, you want your family to have the money to pay off the mortgage balance and stay in the house, right?
- Have enough life insurance to cover anywhere between five and nine years of lost income (that is, the salary, bonus, and so on, that you would've received if you were still alive). Factors to discuss with your insurance agent include whether your spouse also works (and if your spouse will continue to work if you die or have to stay home to care for young children, for example) and upcoming costs and expenses (such as college for your children) that aren't part of your budget right now but soon will be.

You can reduce or even eliminate your future-income insurance needs if you have lots of assets (cash, money in treasury bills, or bank certificates of deposit, and so on) that your family can use to pay the mortgage and live off of for several years. But you should err on the conservative side when thinking about your future-income insurance needs, so do not underinsure future risks.

WARNING

However, if most of your valuable estate is in stocks and mutual funds, watch out! You still need adequate insurance to cover the loss of future income if some — or maybe even most! — of those investments suddenly turn sour. Think about the early 2000s dot-com stock bubble, the 2007–2009 Great Recession, or the brutal stock-market downturn at the beginning of the COVID-19 pandemic. What's that you say? We got past all those broad stock-market downturns sooner or later? Well, suppose you had invested your stock money not in the "market as a whole" through mutual funds or similar investments, but instead made big bets on high-flying stocks that wound up crashing. There goes a big chunk of your estate planning!

Similarly, if most of your high-value estate is tied up in real property (your primary home, your vacation home, real-estate partnerships, and so forth), you also need adequate insurance against loss of your future income, particularly if most or all the real property value is in your primary residence that still has a sizable mortgage or if selling your real estate suddenly isn't quite so easy.

Again, work with your insurance agent to figure out if you need to worry about including life insurance against lost income.

TIP

You may need more than life insurance for this particular strategy. As we discuss later, long-term disability insurance protects you against lost income if you're still alive but you can't work because you're disabled, and long-term care insurance helps prevent your assets from having to go entirely toward nursing-home costs or other very expensive alternatives, possibly for the rest of your life. So, don't forget to work with your insurance agent on long-term disability needs, too!

Shielding the gifts you hope to leave behind

The first two insurance strategies we describe deal with protecting your assets and property: what you have right now, as well as what you reasonably expect to have as a result of your income. However, you may find that insurance (life insurance, in particular) can play a third, important role in your estate plan — essentially creating cash that goes to one or more of your beneficiaries after you die (and we're not talking about counterfeiting money and breaking the law).

Suppose your estate is valued at $1.75 million, but it's comprised of two main pieces: your paid-off home worth $250,000, and your successful business that you began 25 years ago, now worth $1.5 million. You have a son and a daughter. Your daughter has worked with you in the business since she was in high school and now runs the business's day-to-day operations, while your son decided to pursue a career in the military and now lives across the country from you.

Your big problem: How can you adequately and fairly divide up your estate between your two children?

Some options that you consider — and reject — include the following:

- **Leaving the business and the house to both children:** Not a good idea, you decide, because your son has no interest in the business. Plus, because of his military career, he isn't in a position to contribute to the business's success, even if he were made a silent co-owner with his sister. Essentially, your daughter would be doing all the work and your son would be sharing in the profits. Furthermore, your son may have little or no interest in the house and not want to be burdened with real-estate taxes, maintenance, and so on.
- **Leaving the business and the house to your daughter with the provision that she pay your son to compensate for the ownership you don't leave to him:** If you were to require that your daughter come up with $750,000 in cash to give to her brother for his "interest" in the business and another $125,000 for the house, she may very well have to sell the business or take out large loans she doesn't want to assume. Also not a good idea, you figure.
- **Leaving the business to your daughter, and the house to your son:** Sure, the business is far more valuable than the house, and maybe your son will be

satisfied with his second-place status in your estate. But if your son is still in the military and doesn't live anywhere near you, he may want nothing to do with the house, either as a potential home for his family in the future or as rental property.

Perplexed? Here's a simple solution for you: Leave the business and the house to your daughter, and purchase a life insurance policy for yourself with a death benefit of $1.75 million that has your son — and only your son — as the beneficiary. This way, each of your two children receives the same amount (more or less, depending on the current value of the business and your home) when you die, even though you don't have $3.5 million in your estate!

TIP

This insurance policy–based strategy allows you to use life insurance as a way to create cash when you die to balance the amounts your beneficiaries receive that you specify in your will or with other forms of ownership, such as joint tenancy with right of survivorship (see Chapter 6 on will substitutes).

WARNING

One potential downside to this strategy is that the life insurance premiums (monthly, quarterly, annually, or so forth) become much more expensive the older you get. So, although you're relatively young — in your 40s, for example — that $1.75 million policy payable to your son may cost you $2,000 to $3,000 per year (for a term life policy, which we briefly discuss later in this chapter), depending on factors, such as whether you smoke, other aspects of your health, and so on. But by the time you reach your 60s, you pay significantly more each year to maintain that same level of coverage.

Therefore, you need to work with your insurance agent to look at various scenarios, such as using the preceding strategy to create cash for some period of time (for example, 15 to 20 years) and then perhaps switching to some alternative way to divide up your estate when life insurance becomes prohibitively expensive. Perhaps when life insurance is unaffordable (or maybe even unattainable, if you can no longer find coverage) your son will have retired from the military and now be looking at a second career, perhaps even working with his sister in the family business after all this time.

You need to be flexible and adjust your plans to the situation. Life insurance may work for 10 or 20 years, but afterward, some other technique or strategy may be better for you and your beneficiaries. Make sure to adjust as necessary.

REMEMBER

Your estate plan is a series of so-called "living documents" (that ironically deal with your demise!). Changes in your circumstances and life events *will* occur (life happens!), and they aren't limited to you. Your beneficiaries will also have life changes, and your estate plan needs to adjust for these changes and adapt where needed.

WARNING

Additionally, as we discuss later in this chapter, your life insurance proceeds may be subject to federal estate taxes, depending on how you structure the policy's ownership. So, if you're using life insurance to equalize what your beneficiaries receive, make sure to set up the policy correctly (as we discuss in this chapter) to prevent a significant amount of money going to pay federal estate taxes and resulting in the same imbalance among your beneficiaries that you were trying to avoid in the first place! Taxes, in one form or another, play a role in most of your financial decisions, including insurance.

Sorting Out the Kinds of Coverage You Need

For your estate planning, as well as your day-to-day needs, consider the following types of insurance, each of which we discuss in one of the following sections:

- Life insurance
- Health insurance
- Disability income insurance
- Long-term care insurance
- Automobile insurance
- Homeowner's (or renter's) insurance
- Umbrella liability insurance

Yes, we know that you probably already have at least a couple types of these insurances — automobile and health, in particular — but we want to give you an estate-planning perspective on insurance that you may not have thought about before.

TIP

Make a consolidated list of all insurance coverage you have from all the listed types, including the name(s) of the insurance companies, the contact information for the insurance company, your policy numbers, and the location of the actual policy documents that are probably jumbled amidst all kinds of other important papers somewhere in your house! Your estate's personal representative will almost certainly thank you for being so organized (although you'll no longer be around to receive their gratitude!).

For a far more comprehensive discussion about various types of insurance than we can provide in the limited space we have, check out *Insurance For Dummies*, 2nd Edition, by Jack Hungelmann (Wiley).

Life insurance

Life insurance works on a very simple premise. If you die while you have a life insurance policy in effect, the insurance company pays money to your beneficiaries. Of course, the details are a bit more complicated, particularly who receives the money and how much.

Because life insurance is such an integral part of your estate planning, we have an entirely separate section later in this chapter that takes you inside various types of life insurance. For now, we focus on why you need life insurance, such as the following reasons:

- **Replacing your income if you die:** You may plan on living until your retirement years, earning income from your job or business along the way and not only paying your family's regular bills but also socking away a tidy sum to cover expenses during your retirement. But suppose you die young? Can your family get by on what you've saved so far plus your spouse's income? Or will your family be forced to sell the house and scale back dramatically to try and make ends meet because you're no longer around to provide for your family? Of course, you need to match your particular situation with your insurance needs. If you are unmarried and have no dependents, and you haven't planned on leaving your life savings to another family member or to your favorite charity, your untimely death may not have quite the financially devastating impact as if you had a spouse and several young children. Still, the main point to remember is that one of the primary purposes of life insurance is to replace income that you would've otherwise earned if you were still alive.
- **Improving your estate's liquidity:** *Liquidity* is a financial term that basically means readily available cash or an asset that can be quickly turned into cash. Suppose when you die you have a substantial estate worth $5 million, but almost all your estate is in your primary residence, your two vacation homes, and your investment in your business. You may have heard the old saying, "Rich people don't have any money," or the one that goes, "All his money is tied up in wealth." The point is, even if you're well off financially your personal representative may not be able to distribute large sums of cash very easily, depending on the particular investment portfolio. So, if your family needs money for living expenses or for some other substantial cash needs after you die, life insurance can be an important tool to provide cash without your family or other beneficiaries having to sell property that they otherwise wouldn't.

- **Paying off your debts:** Life insurance can provide money to pay off your estate's debts — mortgages on real property, business loans, and even sizable personal loans.
- **Providing money for estate taxes:** Instead of your family having to sell property to come up with money for estate taxes, life insurance proceeds can do the trick.

See the section, "Looking More Closely at Life Insurance," later in this chapter, for more about life insurance.

Health insurance

We hope you have some form of health insurance, either through your job or business or through some other source (such as an association to which you belong or the health insurance marketplace available because of the Affordable Care Act). Because if you don't have health insurance, you run a very high risk of watching much of your estate suddenly get whisked away to pay for medical bills.

WHAT IF YOU DON'T HAVE A SPOUSE AND CHILDREN?

The conventional wisdom about life insurance is that you need to provide money for your spouse and dependent children in the event of your death. But if you don't have to worry about paying for your children's college education after you're gone, or to provide money for your spouse to keep paying the mortgage on your house, then you probably don't need insurance. Therefore, the equation may be stated as "no spouse + no kids = no life insurance needed."

Not so fast! Suppose you're an avid supporter of a charitable cause, such as a small local animal shelter, and you regularly give hundreds of dollars every month to the charity and plan to do so for years to come. Perhaps, you're one of the shelter's primary benefactors. So, what happens if you die suddenly, especially if you have a fairly modest estate without a lot of assets? Even if you leave your entire estate to the charity, you're only talking about a fraction of the total amount of money that would otherwise be available if you remain alive for many years and keep making your regular monthly contributions.

In this case, you may want a life insurance policy to make sure that even if you were to suddenly die, money would be available for the charity as if you were still alive and donating a portion of your salary every month.

WARNING

How high is this risk? Approximately two-thirds of all personal bankruptcies are due to medical bills. That's pretty darned high! Earlier, we mention how bankruptcy can destroy any estate planning you've done. So, there you have it: a direct relationship between sufficient health insurance and the health of your estate plan.

Many people are accustomed to health insurance in the form of health maintenance organizations (HMOs) or preferred provider organizations (PPOs), where your primary interaction (and concern) is how much your deductible is for office visits and prescriptions, or health savings accounts (HSAs), which offer you additional benefits of lower taxes and retirement savings. But at the most basic level, you must view health insurance as a means to help you pay for very high (and usually unexpected) health-related costs, such as extended treatment for cancer, care and rehabilitation after a heart attack or stroke, or any one of numerous other medical catastrophes that could befall you.

TIP

So, from an estate-planning perspective, make sure you clearly understand the details of your health insurance policy beyond the deductible amounts printed on your insurance card. Pay particular attention to any maximum amounts associated with your policy, such as the maximum payment for a particular incident or any maximum lifetime benefits. Also, understand deductible amounts (if any) for hospitalization. If your insurance policy covers 80 percent of hospitalization costs (versus 100 percent) and you find yourself paying 20 percent of a very expensive prolonged stay for a serious accident or illness, your estate could get hit with a fairly heavy bill.

For example, take a look at Jack Sprat. Jack is 55 years old and works for a company that another company bought out last year. Thankful that he survived the mass layoff frenzy, Jack doesn't give a second thought to the new list of health insurance options during the company's most recent open enrollment period. He simply signs up for the plan with the lowest premium payment each paycheck as he always did.

Stressed out from the pressure at the new company (profits are down, the stock price is down, rumors of new layoffs are circulating), Jack — who isn't in the greatest physical shape anyway — suffers a heart attack that puts him in the hospital for several weeks. After several more weeks at home recuperating, Jack goes back to work, only to suffer another heart attack, this one putting him in the hospital for a month.

Because Jack didn't really pay much attention to what his health insurance policy did and didn't cover, he's shocked (and almost suffers yet another heart attack!) when he starts receiving bill after bill for various doctors and hospital stays, all adding up to a total of $55,000 that Jack has to pay.

(***Remember:*** His policy only covered 80 percent of hospitalization and related doctor charges.) And in Jack's particular circumstances, having to come up with $55,000 isn't quite that easy. He has to cash in stock investments, sell collectibles, empty his bank accounts, and so on.

TECHNICAL STUFF

Most health policies *exclude* out-of-network costs from counting against that out-of-pocket limit. So, Jack could very well owe $55,000 — or maybe a whole lot more — despite the out-of-pocket limit on his health insurance.

Now most of Jack's estate planning is in ruins. Various giving clauses in his will (see Chapter 3) are no longer valid because they reference certain tangible personal property (specifically, certain collectibles) that Jack had planned to leave to his oldest son, but that he now no longer owns. He also had to sell his small share of a real-estate investment partnership in which he had a joint tenancy with right of survivorship form of ownership.

The moral of the story: If Jack had adequate health insurance coverage for his particular situation, his estate plan may not have been turned topsy-turvy because of the unfortunate sequence of heart attacks and the resulting medical expenses.

WARNING

"No big deal," you may be thinking. "For my situation, I have plenty of cash and I can come up with $55,000 without any problem." Perhaps, but suppose you suffered some type of illness or injury that resulted not in hundreds of thousands of dollars in medical bills, but instead several million dollars in hospitalization, doctors, prescription drugs, and other costs.

Suddenly, the out-of-pocket equivalent is a lot of money to anyone, and it can dramatically disrupt anyone's estate plan!

TIP

Selecting the most appropriate health insurance coverage isn't simply a matter of looking for a plan with the lowest possible premium payments or "first dollar coverage" (that is, all medical expenses are covered by the insurance, but you pay a much higher premium). You need to look at what's covered and what isn't — and how much the "what isn't" may cost you — and consider the impact on your estate plan if any worst-case scenarios come to pass and you need to lay out a lot of money.

Disability income insurance

Disability income insurance (often referred to as simply disability insurance) provides you with protection against a serious illness or injury that affects your ability to earn a living. Basically, if you get hurt or sick and can't work — but you're still alive — disability insurance provides payments to cover your living expenses and replace your income.

WARNING

How important is disability insurance? Great question!. Statistically, during your working years you are over *three times more likely* to be injured and need some form of disability insurance than you are to die and need life insurance.

You typically come across two different types of disability insurance, usually provided by or made available through your employer (though if you're self-employed, you can buy disability policies, just as you can buy health insurance or other forms of insurance). The two types are

- **Short-term disability,** which usually covers a period of three months (sometimes longer) and is often provided by using your current and sometimes future paid time-off (PTO) balance
- **Long-term disability,** which as you may guess from the name, covers long periods of time — up to many years — by replacing a sizable portion of your income

WARNING

Some employers offer disability insurance as part of their benefits package. Be sure to ask if this is short-term or long-term disability insurance. Don't think that you're covered by disability insurance if you only have short-term disability. Having long-term disability in place will protect not only your loved ones but also your estate plan.

You can find all kinds of variations with long-term disability insurance, so make sure you fully understand what your benefits are if you need to use the insurance. For example, some policies cover a fixed percentage of your salary — often around 60 to 67 percent — while other policies give you a choice as to how much of your salary is provided, ranging from 50 to 80 percent (with correspondingly higher or lower premium payments).

Other policies only come into effect if you're totally disabled, while still other more expensive policies may come into effect if you can't work in your chosen profession but still can perform some other type of paid work.

Some policies have a cost-of-living adjustment feature (that is, the payments go up each year according to increases in inflation rates or some other cost-of-living measure) — something to pay close attention to if you're dealing with several decades of coverage because of disability.

Finally, most long-term disability policies provide coverage until the age of 65 (at which time government-provided health benefits can kick in), unless you want to buy coverage for a shorter period of time (for lower costs, of course).

TIP

In Chapter 18, we discuss Social Security disability benefits that you may receive in addition to long-term disability insurance that you purchase. When you're figuring out how much disability insurance you need, check to see what your expected Social Security disability benefit will be if you become disabled and factor that amount into the equation. You can probably purchase a smaller amount of long-term disability insurance and pay lower premiums while still providing the coverage you want and need because of what you receive from Social Security.

From an estate-planning perspective, the relationship between long-term disability insurance and protecting your estate is fairly straightforward. Earlier in this chapter, we discuss how part of your insurance–to–estate planning relationship likely is to protect against the loss of future income, in addition to protecting property that is currently part of your estate. Long-term disability, along with life insurance, is a very important part of this strategy.

WARNING

If you can't work due to an illness or injury and you don't have long-term disability insurance, you can lose nearly everything. You may have to cash in your accounts and sell all your personal and real property to make up for the lost income. From a medical perspective, you can at least receive rudimentary care through government-provided programs for those who can't pay, but at quite a price. Essentially, if you fail to protect against the loss of future income, you may lose everything you already have.

SOME OMINOUS STATS ABOUT DISABILITY TO CONSIDER

You may think of estate planning primarily or solely as pertaining to what happens after you've passed away. However, consider the following data points that emphasize the importance of considering the possibility of becoming disabled when it comes to your estate planning:

- If you're under age 35, the chances are one in three that you will be disabled for at least six months during the course of your career.
- Men have a 43 percent chance of becoming seriously disabled during their working years. Women have a 54 percent chance of becoming seriously disabled during their working years.
- At age 42, it's four times more likely that you'll become seriously disabled than that you will die during your working years.

- Three in ten workers entering the workforce today will become disabled before retiring.
- An illness or accident will keep one in five workers out of work for at least a year before the age of 65.
- One in seven workers can expect to be disabled for five years or more before retirement.

Long-term care insurance

Long-term care insurance is somewhat similar to long-term disability insurance. Long-term disability insurance provides you a salary when you're unable to work, and long-term care insurance covers the costs of long-term health care, such as nursing-home coverage or home health care to stay in your home and age in place.

Long-term care insurance options have changed significantly. The traditional long-term care insurance provides a monthly benefit for care options such as assisted living, nursing-home care, or home health care when you meet the threshold of not being able to independently perform a predetermined number of activities of daily life (ADLs), such as eating, bathing, dressing, using the toilet, or getting in and out of bed or a chair. You pay an annual premium for the rest of your life in order to receive these benefits. The problem is that most premiums are not fixed and can increase significantly over time.

New hybrid versions of long-term care insurance are a mix of life insurance and long-term care insurance that can provide death benefits to your beneficiaries. These long-term care policies also have a lump sum, 5-pay (5 years), or 10-pay (10 years) for the premium payment instead of annual payments. On the positive side, you pay the premium over a short period of time and don't have to worry about future premium increases, which may make the insurance unaffordable. On the negative side, you have to come up with a chunk of change up front, which can be a six-figure amount.

Here are some important factors to consider about any long-term care insurance:

- **COLA clause:** No, this is not a soft-drink reference. This cost-of-living adjustment (COLA) clause increases the benefits to keep up with inflation. For example, a $5,000-per-month benefit in today's dollars would need to increase to over $9,000 per month in 20 years with just 3 percent annual inflation. So, the value of your monthly benefits is almost cut in half. To avoid this, you can include a COLA rider on your policy, but there can be a substantial cost increase in your premium for the COLA adjustment.

» **Indemnity versus reimbursement:** This is an important distinction in terms of how you'll receive your benefits. The reimbursement plan requires you to submit invoices and get reimbursed for the actual cost of your care. The indemnity plan pays the maximum predetermined benefit amount regardless of your actual cost. This means you could receive more benefits than you need on a monthly basis and can save the leftover amount (although given the anticipated continuing rise in health care, there may not be anything left over). That said, the indemnity offers a desirable benefit. In the case of cognitive impairment or even physical impairment, it's much better to have your benefit deposited directly into your bank account and not have to deal with the paperwork requirement for reimbursement plans.

TIP

Look at long-term disability insurance and long-term care insurance in concert with one another, evaluating income replacement needs, what amount of health-care costs you need to cover, and other financial and personal factors.

Keep in mind that long-term care insurance is an important part of your estate plan, not only for your elderly years but also in the event of a debilitating injury. Make sure to shop around — long-term care insurance can vary greatly in both the cost of the policy and the benefits provided.

TIP

Think of long-term care insurance as a cross between health insurance and long-term disability insurance. Ask your insurance agent to help you figure out how much coverage you need to cover medical expenses, and how this coverage can be tied into your long-term disability insurance. You may determine that your assets are significant enough and decide to self-insure for long-term care, but carefully analyze this option to make sure you feel comfortable doing this.

TIP

Also, ask if the insurance policies have any gaps in how they relate to one another. For example, you max out your health insurance, but a particular long-term care policy doesn't kick in for one reason or another, essentially leaving you without coverage (and subjecting your estate to the lack of protection that you're trying to avoid in the first place through insurance).

Automobile insurance

For estate-planning purposes, you really only need to focus on the liability coverage provided by your automobile insurance policy.

WARNING

Many people gloss over the confusing language in automobile policies about liability limits, wondering what's the big deal about "per person" and "per accident" amounts. Work with your insurance agent — or if you don't have an insurance agent, an insurance company representative with whom you speak over the phone when you set up or modify your policy — to thoroughly understand what the language in your policy (or the policy you're considering) means.

When working with your insurance agent, go through several accident scenarios involving one or more vehicles, one or more other people, and other factors to understand what your policy covers, and — even more important — what your policy *doesn't* cover. Then take a look at the impact on your estate plan, particularly how the policy can help protect what you have (in this case, from the result of a lawsuit or out-of-court settlement).

Homeowner's or renter's insurance

As with automobile insurance, you must consider the liability protection component with your homeowner's or renter's insurance policy if an accident happens on your property and someone sues you. Make sure that you clearly understand what's covered and what isn't.

As with most types of insurance, you're trying to prevent assets you currently have from being taken away. Ask your insurance agent to clearly explain any worst-case scenarios that may be expensive and may adversely impact your estate plan.

Umbrella liability insurance

Even though you probably have some degree of liability coverage through your automobile and homeowner's or renter's insurance policy, you may need additional liability insurance. Basically, the more your estate is worth, the more likely it is that someone will sue you in the event of an automobile accident or an injury on your property.

An umbrella policy provides — as the name implies — additional coverage above and beyond your other liability coverage. Furthermore, the policy helps protect you against a financially devastating judgment in a lawsuit (or even a settlement to which you agree). As with the other types of insurance coverage we discuss in this chapter, stress to your insurance agent that you want to protect the property in your estate.

Don't overlook an umbrella policy because it can provide much-needed insurance protection for a relatively inexpensive cost.

TIP

Remember the question that we use several times in this chapter: "What's the worst-case scenario, and how will my estate plan be affected?" Always ask your insurance agent this question about any type of insurance and the various policy options you consider. Make sure that you clearly understand the answer and that you balance all the insurance costs with what you have at stake. Again, a good insurance agent can help you protect what you can't afford to lose without trying to gouge you with very expensive coverage that essentially over-insures you.

Looking More Closely at Life Insurance

In this section, we provide you with a concise overview of life insurance that may be pertinent to your particular estate plan. You can find much more detailed information in *Insurance For Dummies,* 2nd Edition, by Jack Hungelmann (Wiley).

REMEMBER

From an estate-planning perspective, various forms of life insurance play different roles as part of the three-pronged strategy we discuss earlier in this chapter. Specifically:

- Life insurance primarily protects against the loss of future income, as well as protects your assets from being sold to cover your future income that is now lost because you've died.
- Life insurance creates cash if a significant portion of your estate is concentrated in an asset that can't be easily divided, such as your business.
- You can leave various life insurance policies that build up a cash value to one or more beneficiaries along with other property in your estate, such as stocks and bonds.

Whole life insurance

A *whole life insurance* policy is sort of the "granddaddy" of life insurance, and for many years it was the staple of many Americans' life insurance needs. You pay a premium (typically, every quarter or every year) and receive insurance coverage, and along the way a portion of your payment is set aside and earns interest, sort of like a bank savings account. The cash value is yours, and you can take loans against the value while the policy is still in effect or, if you cancel the policy, you get the cash value as the proceeds.

A variation of whole life insurance is *universal life*, which became popular in the high-inflation, high-interest-rate early '80s. Universal life can get complicated, but basically, you can get a guaranteed minimum return just like with a whole life policy, but you also have the opportunity to earn more based on factors spelled out in your policy. If your return is high enough, you may not even have to make premium payments for some period of time because the premium is taken out of your gains. But as with whole life, the important point to note is that universal life policies build up a cash value.

With a *variable life* insurance policy, you have a say in how some of your premiums are invested by the insurance company, such as in bonds or even in the stock market. However, your principal is at risk and you can actually lose some or all of your principal, as in the case of poor stock market performance. Be careful about going the variable life route, and know what you're getting into if you go down that path.

Term life insurance

Many people choose to stick with *term life insurance.* You can think of term insurance as pure insurance. If you die and the policy is in effect, the insurance company pays your death benefit. If, however, you no longer have the policy in effect for any reason when you die, then the insurance company doesn't pay anything.

VARIATIONS ON THE LIFE INSURANCE THEME

Most insurance policies feature periodic premium payments as long as the policy is in effect, regardless of whether those payments stay the same for the policy's duration. Additionally, life insurance typically covers only one person: you. However, you may find variations along the way that you may want to consider. For example:

- A *single-premium policy* is one in which you pay a rather sizable amount of money up front when the policy goes into effect.
- A *first-to-die* policy covers you and another person on a single policy (as contrasted with each of you having your own life insurance policies), and the insurance company issues payment whenever the first one of you dies.
- A *second-to-die* policy also covers you and another person, but the insurance company issues payment when the second person dies.

Review with your insurance agent and financial planner any of these variations you may be interested in — as well as new policies that insurance companies develop — to make sure they make sense for you and your estate.

As with the various types of permanent, cash-value insurance policies, you find all kinds of variations offered to you by insurance companies. Some policies are called *annual renewal term* policies, and your death benefit stays the same as your premium payments go up periodically (for example, every three years while you're very young, and then annually once you reach a certain age). Other term policies allow you to lock in a fixed premium price for some period of time — typically, from 10 to 20 years — rather than have those premiums increase over time. Still other *decreasing-term* policies leave the premium payments the same but over time decrease the death benefit of the policy.

Business-provided life insurance

You can receive other life insurance courtesy of your employer or the business you own or co-own. *Key-person insurance* is life insurance on (as you can guess from the term) a key person in a company, such as the chief executive or one of three partners of a small, closely held family business. (You'll most likely see the term *key-man* insurance but we prefer the gender-neutral terminology.)

TECHNICAL STUFF

Split-dollar insurance is a rather complicated insurance mechanism that is often used by companies to insure the lives of executives at or above a certain level (for example, all assistant vice presidents, vice presidents, senior vice presidents, and up) and to provide those executives with a company-paid benefit in the form of a cash-value insurance policy. If you have a split-dollar policy through your employer, ask someone knowledgeable in your human resources organization to walk you through the details.

TIP

In Chapters 15 and 16, we discuss estate-planning needs for family businesses. You definitely need to look at business-oriented life insurance — particularly key-person insurance — as part of your strategy to keep your business viable if something happens to you or someone with whom you're in business.

OTHER COMPANY-PROVIDED LIFE INSURANCE

Even if you're not a senior company executive, you may have company-provided life insurance, and not even know it! Beyond basic life insurance coverage available to every employee, as well as optional coverage employees can buy, many companies provide their employees with additional life insurance in the case of accidental death while on company business or travel. Check with your human resources department or on your company's internal website for details, and factor any additional contingency life insurance into your estate plan. Make sure your family and personal representative are also aware of the coverage you have.

Understanding Life Insurance Tax Implications

WARNING

Even if you've taken great care to protect your estate with adequate amounts of life insurance, you may unwittingly create a federal estate tax trap that can cost your estate lots of money!

If you "have control" over your life insurance policy (more on what "have control" means in a moment), the death benefit of the life insurance is added into your estate's value, just as if that money were in a savings account.

For example, suppose you die in 2026 when the exemption amount for federal estate taxes is scheduled to be reduced to approximately $6 million (the exact amount of exemption will be adjusted for inflation), and the total value of all the savings accounts, stocks, bonds, real estate, and collectibles in your estate is $5.5 million. You won't owe any federal estate taxes at all because you're $500,000 under the exemption amount that federal estate taxes kick in, right?

Not so fast! Suppose you have a term life insurance policy that pays $750,000 to your oldest daughter upon your death, but you "have control" over that policy. According to the rules of the federal estate tax game, $750,000 is added to the total value of your stocks, bonds, savings, and property, so now your taxable estate is valued at $6.25 million (the $5.5 million plus the $750,000 death benefit of the life insurance policy). So, estate taxes kick in because your taxable estate, including your life insurance, is above the exemption amount in the year you die.

You're pretty much out of luck when it comes to federal estate taxes on your life insurance, right? Not quite. It depends on when you die. First, realize that even with the death benefit amount of your life insurance added in, you may still not have to worry about federal estate taxes at all. Assuming the same details as the preceding example, if you were to die in 2025 — when the federal estate tax exemption amount is significantly higher, at $12.06 million — your taxable estate of $6.25 million including your life insurance is still under the exemption amount, so no estate taxes for you!

Even with the much lower exemption amounts scheduled to return in 2026 (unless changed by Congress), you still may not have to worry about estate taxes if the value of your estate is fairly modest. For example, an estate of $500,000 augmented by an additional $250,000 in life insurance is free of federal estate taxes in all cases. (See Chapter 13 for more on the death tax.)

But what if you're above the exemption amount with your estate and your life insurance? Good news! You have a couple tricks up your sleeve. Basically, you can "give up control" over your life insurance policy to have the value of the death benefit excluded from your estate for federal estate tax purposes. You can give up control in several ways, the most popular being the following:

- **You can simply transfer the ownership of the policy to someone else, such as a family member or friend.** By doing so, you give up the right to change beneficiaries and make other changes to your policy, but the policy is no longer considered to be within your control. Transferring a life insurance policy could result in gift taxes or federal estate taxes and even have adverse income tax consequences, though; check with your estate-planning team for the details on your particular situation. You also need to be aware of the three-year "tax timer" on life insurance policy transfers (see "The pesky little details" sidebar).
- **You can use an *irrevocable life insurance trust* (see Chapter 8) as an ownership vehicle for the policy.** Again, you give up control but now no longer have to worry about the death benefit being included in your estate. But again, gift or federal estate tax issues may apply.

WARNING

You need to work with *both* your insurance agent (who may focus primarily on selling you an appropriate amount of coverage instead of worrying about estate tax implications) and also your attorney (who is knowledgeable about the rules that determine whether you have adequately given up control).

Particularly, if you want to set up an irrevocable life insurance trust, you definitely need to work with your attorney.

TECHNICAL STUFF

You also need to get up-to-date advice on the relationships involved for the beneficiary or beneficiaries of your policy, who owns the policy, and who pays for the policy. Make sure that when all the pieces of the puzzle are put together, the end result is life insurance that is estate-tax free. Also, state tax laws vary, so check with your attorney about any state-level considerations that affect your life insurance.

THE PESKY LITTLE DETAILS

Uncle Sam doesn't make it easy for you if you're trying to give up control of an insurance policy. You need to be concerned with some of the small details. Of particular concern is the *three-year rule* that states if you transfer ownership of a life insurance policy within three years of your death, then the death benefit of that policy is added into your estate, even if another person owns the policy or you've created an irrevocable life insurance trust. Check with your attorney to make sure these details don't burn you.

Asking the Right Estate-Related Questions about Insurance

You already know some of the critical questions to ask your insurance agent, company HR department, or whoever is responsible for signing you up for any type of insurance. You need to find out what the policy covers, what the policy does not cover, when it kicks in (for example, when the life insurance is paid after you die, when health insurance is paid after you go to a doctor or get taken to the hospital), how much the policy costs, and so forth.

Other specific questions to ask about all types of insurance include the following:

- **What is my worst-case scenario?** We already mention this question several times, but we can't emphasize it enough. You find all kinds of limitations and exclusions buried in the fine print of any insurance policy, from your basic automobile policy to life insurance to long-term care insurance. You want to find out, and you may want to phrase the question this way: "If I buy this policy and pay all my premiums, what can happen to me that *won't* be covered by this policy and will cost me lots and lots of money?" The answer to this question can help you decide if an insurance policy provides what you're looking for — protection against the worst-case scenario — and if that particular policy is worth the cost.
- **Which of my assets are at risk?** Your state may have laws that put everything you have at risk if your insurance coverage isn't sufficient to cover a lawsuit, medical expenses, or whatever — or perhaps certain assets are exempt, such as your primary residence. Make sure you clearly understand what you can keep if you don't have adequate insurance and you (or your family) must start selling off assets to raise enough cash to cover the insurance shortfall.
- **When does this insurance coverage end?** Estate planning is a long-term proposition, stretching from now until after you die. Sometimes you can keep insurance coverage for the rest of your life if you want. In other situations, your coverage may last only until you reach a certain age, if your employer is acquired by another company, if you're successfully sued (because your insurance company can then drop you), or something else occurs. Part of your estate-planning responsibility is to make sure you have adequate control and protection and that as you get close to death, your estate isn't unreasonably exposed to losing everything.
- **What safety nets exist beyond this insurance, and what are the catches?** If you need long-term medical or nursing-home care and you simply don't have the money or adequate long-term care coverage, your state may provide

the care you need (depending on its current "social net" policies, which may change over time due to politics), with a catch. As we discuss in Chapter 10, the *Estate Recovery Act* requires your state to go after your estate to recover the costs they put out. So, the good news is that you do have a safety net, but the bad news is that much, or perhaps most, of whatever is left in your estate may go to pay for that safety net after you die. Make sure you clearly understand the relationship between insurance and any down-the-road impacts on your estate, such as the state coming after your property because you were forced to use that safety net.

TIP

As with many aspects of estate planning, you need to keep an eye on legislative changes that may affect your estate-planning decisions. A 2022 bill introduced to Congress could end estate recovery programs and estate recovery liens that take back Medicaid expenses by going after the assets of the deceased. Stay tuned!

IN THIS CHAPTER

- Sorting out what your retirement-related assets are really for
- Deciphering difficult factors in retirement planning and estate planning
- Figuring out how traditional pension plans relate to your estate

Chapter 18

Connecting Your Retirement Funds to Your Estate Plans

Your retirement accounts, such as pension plans, individual retirement accounts (IRAs), and 401(k) plans, are like any other asset you own when it comes to estate planning. First, you decide how to use them — more or less — to fund your retirement. After you die, the amount left is part of your total estate's value when somebody (like your attorney or personal representative) figures your final tax bill, if any.

You also need to decide how you want to divide up these accounts like the other assets in your estate. For example your spouse gets the proceeds from your 401(k), while your kids receive the proceeds from one of your IRA accounts.

REMEMBER

Because retirement account assets are non-probate assets, with the accounts passing to the named beneficiary of the account, you don't need to include these assets in your will.

This chapter helps you make some decisions concerning your retirement-related assets and understand how to best use expert advice.

Deciding What Your Nest Egg Is Really For

You can take one of two approaches to linking your retirement plan with your estate plan:

- Using most or all your assets to fund your retirement and only leaving behind a few leftovers in your estate when you die
- Using part of your assets to fund your retirement and then having specific and significant estate-related goals for what's left in your estate when you die

We discuss each of these two approaches in the following sections. Essentially the question you need to ask yourself is this: "Are my retirement funds really for my retirement?"

REMEMBER

No matter which of the two strategies you follow, what you plan to do with your nest egg is a key topic to bring up when you talk with your financial adviser.

UH, I THOUGHT MY RETIREMENT ACCOUNTS WERE FOR RETIREMENT

Use your retirement accounts for things other than retirement? That idea may sound silly, but keep in mind that you may never need to tap into the full value of your IRA, 401(k), or other special retirement accounts during your retirement years. After all, you can defer income taxes on gains (interest, capital gains on stock price appreciation, dividends, and so on) on these special retirement accounts, even though the proceeds from those gains are still left in the retirement account. And in many cases, you can leave money in these accounts for years, essentially giving you a tremendous advantage when it comes to income keeping taxes at bay.

Suppose you have plenty of money in your nonretirement certificates of deposit (CDs), stocks, mutual funds, and other accounts — not to mention a large 401(k) or 403(b) balance. You may even work for a company with one of those now-old-fashioned pension plans. (Technically, a pension plans is a *defined benefit* plan in which your monthly or annual retirement proceeds are part of your employment package and, as the name suggests, are predefined according to factors such as how long you worked for the company, your title or level, and your salary.) All together, these accounts provide more than enough money to fund your golden years of retirement.

If you're fortunate to have so much nonretirement money that you never have to touch your retirement accounts until you absolutely must, you may view your retirement assets as something you pass on to your children, a charity, or some other beneficiary after you die.

On the other, more unfortunate side, if you don't adequately plan for your retirement, you may run out of money and have to tap into assets you had earmarked for estate-related purposes, such as money for your grandchildren, property you had wanted to leave to your favorite charity, and so on.

Strategy #1: Satisfy your needs and plop the leftovers away

With this approach, essentially you're saying, "Leaving money behind isn't important to me. I've worked hard all my life, and I want to use my money to enjoy my retirement years!"

You may still have specific plans about who gets what in terms of assets in your estate, but in your case, you're thinking more of your antique dining room furniture and antique collectibles, not your bank accounts, CDs, stocks, and bonds — the accounts that you'll use to fund your retirement years. When you die, whatever is left — whether your estate's value is a teensy little bit or a lot — goes to one or more beneficiaries.

To accomplish this goal, you'll work with a financial adviser on retirement planning and fill out some moderately complex worksheets that detail what assets you currently have and any debts you have (such as a mortgage, credit card balances, and so forth). Your adviser will plug these numbers into various formulas that make assumptions about factors, such as:

- Your accounts' annual earnings (for example, interest on your bank accounts, gains on your stocks, and so on)
- Your current age, your target retirement age, and life expectancy
- The type of retirement lifestyle you plan (Stay mostly at home? Travel the world?)

TECHNICAL STUFF

All these factors are used as data inputs for software that your financial adviser uses to create a *Monte Carlo analysis*, which can run hundreds or even thousands of simulations and provides you with a percentage probability (between 1 percent and 100 percent) of meeting your retirement goals. An 86 percent probability? Good shot of nailing your retirement goals. A 45 percent probability? Your retirement plan needs some serious tweaking. Your financial adviser will try to figure out as closely as possible how much money you need to have, how much more you need to save and invest, and how much your current and post-retirement spending is. Your adviser will want to make sure you have enough money to fund your retirement and not run out. You don't have to worry about specific amounts to leave behind as part of your estate (more on this topic in a moment).

WARNING

Your retirement plan is only as good as the accuracy of the information you provide to your financial adviser. This is especially true with your current spending and anticipated post-retirement spending. Do you want to travel a lot, buy a second home, or maintain your current lifestyle with no major changes? Many retirement plans are upended due to underestimating — sometimes by a lot! — the amount of money you are spending now and think you will spend during retirement. Take the time to track your current expenses — and we mean *all* your expenses (yes, you need to count your annual vacation and holiday gifts). The accuracy of your retirement plan and making sure it works as projected depends on the accuracy of this information.

Strategy #2: Walk the balance beam between retirement needs and estate plans

The second — and probably more common — approach to linking your retirement planning and estate planning is trying to balance the two disciplines. You want to not only fund a comfortable retirement, but also have a specific plan for your estate, as we stress throughout this book. This approach makes sense when you know the amount of money you plan to leave your children, grandchildren, or charities.

We say it again and again: Make plans with your financial adviser.

REMEMBER

When we say *money* in the preceding paragraphs, we're referring to your estate's property value. As we note in Chapter 1, property can be both real (real estate) and personal (either tangible or intangible, such as your collectibles and your mutual funds, respectively).

Linking Retirement and Estate Planning: A Tough Job, but You Can Do It

In this chapter, we assume you don't want to focus on your retirement plan with the intention of leaving behind only what you didn't use up. Chances are, you're equally concerned about making sure you have enough money to meet specific estate-planning goals.

As you may guess, you have several factors to work out with your financial adviser to achieve this balancing act: your pension plan (if you have one), your retirement accounts, and Social Security. The following sections discuss how various retirement-oriented assets and investments apply to your estate plan.

Tapping into a traditional pension plan

Pension plan. Those two words together conjure up some interesting impressions, depending largely on your particular background:

- Many people, particularly those who came into the workforce during or after the mid- to late 1970s, have little or no familiarity with pension plans and think that pension plans are a relic from a bygone era when people worked at the same company for most or all of their careers before retiring.
- Other people, who have worked for a company that still maintained an old-style pension plan (one that pays you a predetermined amount of money, typically every month, during your retirement years), can't even utter those two words together without bitterly thinking about the years they put into a now-bankrupt, now-scandal-ridden company that essentially has robbed them of promised retirement benefits because the pension plan is also now bankrupt.
- Yet other people — particularly government workers, including those in the military — see a pension plan that starts paying retirement benefits while people are in their 30s or 40s (still young enough to start on an entirely new career) as a just reward for spending a first career with salaries lower than they could've earned elsewhere in the private sector.

Pension plan basics

Surprise! Pension plans do still exist today. If your company offers them, pension plans can very well make up an important part of your estate, which means two important things for you: contingency planning and death tax implications of down-the-road lump-sum payments.

CONTINGENCY PLANS

First, you need to have some type of contingency plan (in other words, a backup plan), particularly if you don't work for a government organization (federal, state, county, or local). If you work for a private company that has a traditional pension plan and the company sinks into the morass of a financial scandal (as we've seen time and time again), your pension benefits may be at risk!

You need to know two things:

- Is your pension insured?
- If it is insured, does the insurance cover all or only part of its value?

The good news is that the Pension Benefit Guaranty Corporation (PBGC), a federal agency, may protect some or all your pension benefits, even if your company fails. As noted on the PBGC website (`www.pbgc.gov`), PBGC protects approximately 33 million American workers' retirement incomes in more than 25,000 defined benefit pension plans that provided a whopping $6.4 billion to retirees in 2021.

WARNING

Keep in mind, though, that the PBGC insures some, but not all, pension plans. The PBGC usually doesn't insure pension plans offered by professional service firms, such as a doctor's office or a law firm that employs fewer than 26 employees. Similarly, church pension plans and government worker pension plans aren't typically insured. Ask your employer's pension plan administrator if your company's plan is PBGC-insured.

Another item of concern — or maybe not — for you is whether all or part of your pension benefit is insured. Maximum amounts change each year and are dependent on your age, but for 2022 up to $6,204 per month, or $74,448 annually, is insured. Additionally, the guaranteed amount is adjusted lower if you begin receiving payments before age 65, or if your pension plan includes benefits for a survivor or some other beneficiary.

TIP

These insured amounts change and are dependent on your age, but you can review the amount of your pension plan that is insured at `www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee`.

As companies usually say in commercials for various products and special offers, "Other restrictions and limitations may apply," so if you have a pension plan, carefully read through the material on PBGC's website.

Even with possible PBGC insurance on your pension plan, double-check from a retirement-planning perspective, as well as an estate-planning perspective, that you have backup plans (money in your IRA account and your other non-retirement savings, for example), in case your pension benefits either evaporate suddenly or never materialize as promised.

TECHNICAL STUFF

We keep emphasizing the importance of keeping up with legislative changes that can affect your retirement plan. The 2021 American Rescue Plan enabled financially troubled pension plans to obtain financial assistance. PBGC created a Special Financial Assistance (SFA) Program that helped the financial threat faced by more than three million participants with troubled pension plans. The SFA Program will provide an estimated $74 billion to $91 billion in funds for these plans to continue paying promised retirement benefits both now and in the future.

LUMP-SUM PAYMENTS

In addition to any regular monthly payments you receive from your pension plan, stay aware of any down-the-road lump-sum payments that may be coming in, particularly any lump-sum amounts that may be paid upon your death to your spouse or some other beneficiary in lieu of future monthly payments. Be sure to discuss these payments with your financial planner and attorney to understand any estate tax implications.

TIP

One of the most important retirement decisions you'll make if you have a pension plan is whether to take a lump-sum payment or annual payment if both options are offered. Do these options sound vaguely familiar? They're the same options offered if you're lucky enough to win the lottery: up-front lump-sum payment or a cumulatively higher annual amount. (But don't play the lottery as part of your retirement plan. The odds are not in your favor.) Be sure to discuss with your financial adviser, as well as your accountant, the various pros and cons of these options and how they factor into both your retirement plan and estate plan.

Key items for your estate plan and your pension

A pension plan can affect your estate plan — for better or for worse — in three ways:

- Covering expenses during your retirement years
- Having a backup plan if your pension income is disrupted
- Planning for inflation

COVERING EXPENSES DURING YOUR RETIREMENT YEARS

From a retirement-planning perspective, your monthly pension-plan payments must match your regular expenses, such as housing, food, planned travel, medical and health care, and so on. So far, we're not talking about rocket science, or even anything out of the ordinary! But now you need to go back to what you determined to be your philosophy about how your retirement planning and estate planning are linked (the spend-it-all versus balanced approaches that we discuss earlier in the chapter). Specifically:

- If your strategy is to balance your retirement and estate plans, and your anticipated pension plan income is roughly equivalent to your anticipated retirement expenses, then you have all the rest of your assets — stocks, CDs, IRAs (which we discuss later in this chapter), crypto investments, and so on — available to include in your estate plan. That is, if you don't intend to spend it all, then you can start giving away property as gifts (see Chapter 11). In your will, you can make provisions to leave other property to your children, grandchildren, or any other beneficiaries.

- If your strategy is to spend all your retirement money (and your anticipated pension plan income and retirement expenses are about the same), then you actually have additional money available for your retirement years (in addition to your pension income). You can move into a nicer apartment or house, travel extensively, or otherwise spend as much of your money as you can while you're still alive. Gifts of property to your children? Significant bequests in your will? Nope, not for you. You can start whittling away at your savings, spending additional money to improve the quality of your retirement years. (Don't forget to set aside at least some of that extra money just in case you find yourself facing significant unanticipated expenses, which can happen in spite of the best retirement planning).
- If your pension plan income is less than your expected expenses and cost of living, then you need to plan to *draw down* (that is, slowly tap into) your assets to cover the shortfall. Again, your retirement–versus–estate planning philosophy comes into play here. If you don't really plan to set aside any of your property to be left to beneficiaries after your death, then you have a bit more money to work with than if you leave behind specific amounts of money as part of your estate. Make sure that your financial adviser knows what approach you want to take as you put together a retirement draw-down plan so your plan can reflect your desires.
- If you're one of the lucky pensioners whose pension income exceeds your anticipated retirement expenses, then you have a pleasant problem on your hands. Specifically, you need to account for money being added to your estate during your retirement years (unless of course, you want to spend the extra money by taking elaborate trips to India and Tahiti and dining at five-star restaurants weekly)! And no, you don't need to be the retired CEO of a major corporation, drawing a pension of more than a million dollars a year (with access to the company jet), to have this problem on your hands. If you paid off the mortgage on your home years ago and plan to live there during your retirement years, and if you don't eat out much or don't like to travel, then even a modest pension can put you into the income-greater-than-expenses category. So, even if your philosophy is to take care of your retirement and not worry about your estate plan, you still need to worry about your estate plan! If you don't have any family to whom you want to leave your property (or if you do have family, but you don't want to leave them any property), you can always give some of your extra pension income to your favorite charity or to some other cause, such as your local symphony. Remember that you want

to have control of where that extra pension income goes instead of accumulating it in your bank accounts and then having your state's intestate laws make that determination for you after you die. (For more information, turn to Chapter 3, where we discuss intestacy.)

HAVING A BACKUP PLAN IF YOUR PENSION INCOME IS DISRUPTED

As we discuss in the previous section, you always run the risk of your pension income being reduced or even being totally lost. Or, on a positive note, one day your pension income may exceed your expenses. Plan accordingly by leaving behind significant bequests to your children and your favorite charities. However, a short time later (and on a negative note), you find your pension income significantly reduced because only part of the payments are covered by pension insurance. Consequently, you may need to shift your retirement plans to begin drawing down some of your savings to cover living expenses. Furthermore, you also may find yourself in a situation where you simply don't have enough money to take care of your retirement expenses and also fulfill the estate-planning goals you once had. Therefore, you probably need to go back to the drawing board and adjust your will and make other changes to your estate plans as necessary.

TIP

Retirement planning is a critically important process that doesn't stop when you retire, whether your own personal "retirement" is actually retiring from work or some other form of retirement. Regardless of what retirement is for you, just as with your estate plan, your retirement plan will most likely need adjustments (minor and/or major ones) to reflect changes — whether to pension income, equity market cycles (downturns or even recessions), or just life factors that require you to adjust your plan. View these adjustments as good things because you're treating your retirement plan as a process, which it is, rather than a stagnant plan. Sound familiar? Estate planning, anyone?

PLANNING FOR INFLATION

Inflation had not been a problem for many years, but if you're getting close to your retirement years (or you're already there), you most likely remember the late 1970s and early 1980s with double-digit inflation. Even the years immediately before and after that period (the early 1970s and mid- to late 1980s) were hallmarked by relatively modest inflation that often was around 5 percent to 6 percent, and sometimes even higher.

Enter *Inflation: The Sequel,* in the post-pandemic years, featuring super-high inflation not seen in decades. Many pension plans have payments that adjust for inflation, but suppose yours doesn't? With high inflation roaring back, you may find yourself in a situation where you need to adjust your retirement plans to use more of your savings to supplement your pension than you had originally anticipated. You need to make sure that none of the *giving clauses* in your will (see Chapter 3) are suddenly invalid because you've had to sell an asset or use more money than you had anticipated, and money or property that you had planned to leave to a beneficiary is no longer available.

TECHNICAL STUFF

It's pretty easy to not really think about inflation a whole lot, unless you see it in your grocery bill or when you fill up your car with gas. But inflation is the hidden boogeyman stealing the value of your assets, even when inflation is relatively low. How? The average inflation rate in the United States was just above 3 percent from 1914 through 2022; that's 100+ years of data. So, how does 3 percent annual inflation matter? Over a 20-year period, a 3 percent annual inflation rate erodes the value of your asset by almost one-half. That $5,000 pension income would now need to grow to almost $10,000 over that 20-year period to buy the same amount of goods and services. Still not convinced? Well, look at it this way. That $5,000 pension income will only buy $2,500 in goods and services. Inflation matters!

REMEMBER

Your retirement plan is heavily intertwined with your estate plan. If you want or need to change anything in your retirement plan, one of the first questions to ask yourself and the members of your estate-planning team is: "How will this change impact my estate plan?" So, just as salt and pepper shakers are sold as a pair, your retirement plan and estate plan go together.

Managing your IRA accounts

Very few investment vehicles have undergone as many changes over the years as IRAs. IRAs became very popular in the early 1980s as a tax shelter for taxpayers to deduct up to $2,000 of earned income from an individual tax return (more for joint married tax returns). Taxpayers put the money into a special account where it could grow through interest, dividends, and capital gains tax-free until it was withdrawn.

But soon, the tax laws changed so only people not covered by traditional pension plans where they worked could put "pretax" money into an IRA. Soon, the rules for deductibility of contributions started changing every couple of years. Plus, variations of IRAs — such as the Roth IRA (for after-tax contributions rather than pretax contributions) — were introduced. Self-employed individuals had still other variations, such as the SEP-IRA (*SEP* stands for Simplified Employee Pension).

Under the latest tax law, tax-deductible contributions are back, but only if your income is under a certain amount and based on your tax filing status; otherwise, you can still put money into an IRA, but you can't take a tax deduction.

The amount you can contribute changes, sometimes every year, so be sure to track the amounts you can contribute to your IRA accounts.

TECHNICAL STUFF

If you're 50 years old or older, you can also make catchup contributions to IRAs, 401(k)s, and 403(b) plans. Make sure you work with your financial planner to figure out the details.

So far, IRAs sound just like any other savings account or CD (for IRAs invested in fixed-income assets, such as interest-bearing accounts), or for riskier stock-based IRAs, like any mutual fund or other stock investment. So, what's the big deal for estate planning? The answer: three key points that we discuss in the following sections:

- Naming a beneficiary
- Decoding tax implications for your beneficiary
- Adapting your retirement-versus-estate philosophy to your IRAs

TIP

Even beyond tax and estate-planning implications, you need to get up-to-date information about various IRAs and how they can affect your retirement. Basically, the world of IRAs can be very confusing, so ask your financial adviser.

REMEMBER

Here's another reminder of the importance of keeping up with legislative changes that affect both your retirement plan and your estate plan: *Required minimum distributions* (RMDs) say that you have to start taking distributions from your retirement accounts by a certain age. The exceptions are Roth accounts, which do not have RMDs and are often used as accounts that are left to your beneficiaries because they can continue to grow, tax-free, until you die. The 2019 Setting Every Community Up for Retirement Enhancement (SECURE) Act pushed back the RMD start date to age 72 if you're 70½ years old in 2020 or later. And there is current legislation pending that would increase the age to 75 before you'll be required to take distributions. This can have a profound impact on your retirement plan because you could delay taking distributions for a few more years, but the amounts of your RMDs will increase because you have a shorter time period to receive the distributions; these larger distributions could potentially move you into a higher income tax bracket. So, here you have yet another reason to keep up to date on legislative changes and their direct impact on you.

TIP

You have enough things going on in your life without having to try to read a congressional bill that is hundreds of pages long (unless you need that little "something extra" to put you to sleep at night). When major legislative changes are made that affect retirement, you'll find plenty of articles online that summarize these changes and their impact. When you have a grasp on these changes, you can discuss them with your retirement and estate planning team.

Naming your IRA beneficiary

When you create an IRA, you can name a beneficiary for that account, just as you do with a life insurance policy (see Chapter 17). Upon your death, IRA proceeds go to your beneficiaries and don't go through probate.

REMEMBER

As we discuss in Chapters 5 and 6, your estate is technically comprised of two parts: your probate estate (your property that is transferred to others through your will or your state's intestate laws if you don't have a will) and your nonprobate estate (your assets transferred outside of probate, such as through a will substitute like joint tenancy with the right of survivorship).

Again, IRA assets that go to a named beneficiary don't go through probate, meaning that all the advantages of avoiding probate that we discuss in Chapter 5 (speed, privacy, and so forth) come into play. You should also consider naming a *contingent beneficiary* for your IRA.

Contingent beneficiaries, also called secondary beneficiaries, are backup beneficiaries. Think of them as the runner-up in a beauty pageant. If for any reason the winner can't fulfill their duties, the runner-up then becomes the winner! Contingent beneficiaries are important to have in case any changes occur with your beneficiaries.

Decoding your beneficiary's tax implications

WARNING

Certain IRA assets can increase your beneficiary's income taxes! For example, say you live long enough to totally withdraw all your IRA contributions that you made over the years that were tax-deductible. Because you were fortunate enough to avoid taxes on that money on the way into your IRA, guess what: The IRS wants its cut of the money on the way out!

If you die before you withdraw all (or any) of your money, the IRS still wants a cut as if you were still alive. As a result, your traditional IRA's beneficiary has to pay income taxes on the amount received just as if you had received the money.

TECHNICAL STUFF

Many rules related to your IRA beneficiaries have tax implications, and these rules can change. If you don't take the RMD from an inherited IRA, you're subject to a penalty of 50 percent of the amount that you should've taken. But wait, there's more! The SECURE Act implemented a ten-year rule. No, this is not an update to the five-second rule about food dropped on the floor! The ten-year rule requires your beneficiaries to take the full value of the inherited IRA by the tenth anniversary of the IRA owner's death. However, although there are no annual RMDs during those ten years, the account balance must be zero at the end of the tenth year. Leave an amount in the inherited IRA? The IRS grabs a 50 percent penalty tax on the remaining balance. So, you may be thinking, that's my beneficiaries' issue to deal with, not mine. But isn't one of the main points of your estate plan to leave some portion of your estate to your beneficiaries and have them enjoy the maximum amount? We recommend having your estate attorney charge your estate for a couple hours of time and have them review with your beneficiaries not only what you left them, but the requirements they need to comply with to maximize their gift from you.

Adapting your retirement-versus-estate philosophy to your IRA's value

If you intend to spend as much of your money as possible during your retirement years and not worry about leaving behind specific amounts as part of your estate plan, you and your financial planner can plan for you to draw down your IRA balance during your expected lifespan.

If, however, you want to fund specific goals as part of your estate plan, you need to set aside a certain portion of your IRA balance for estate-planning purposes. (For example, you set aside money for your grandchildren and great-grandchildren's education, even after you've died.)

TIP

If you want to leave behind specific amounts and not put those amounts at risk, you need to make sure that a significant portion of your IRA is in safe investments, such as CDs, rather than in riskier investments, such as stocks.

Estate planning for 401(k) and similar plans

401(k) plans are, in many ways, a cross between IRAs and traditional pension plans. Specifically:

- 401(k) plans are structured very similarly to IRAs, though with different limits (and a few restrictions) on contribution amounts.
- Many companies that no longer have (or that have never had) traditional company-funded pension plans instead offer 401(k) plans as the primary retirement vehicle for their employees.
- Many companies offer Roth 401(k) plans as an option; Roth 401(k) plans use after-tax dollars (as opposed to traditional 401(k) plans, which uses pretax dollars for your contributions).

401(k) plans cover employees of privately held or publicly traded companies, while the very similar 403(b) and 457 plans cover government workers and those who work at tax-exempt organizations. Check with your employer's human resources department to see what plan your company offers and what the rules are.

Your company may offer some amount of matching contribution in addition to your own contributions to your 401(k)-like accounts. Very often, companies offer some type of *matching program* — typically an additional 5 percent to 20 percent of your contribution that they add into your account for you, sometimes much more depending on your employer. Also, your 401(k) is a portable retirement vehicle. If you leave your employer, you have a certain period of time to move that money into another tax-advantaged account (such as doing an *IRA rollover* or transferring your money into an IRA account) to avoid penalties.

TECHNICAL STUFF

From an estate-planning perspective, if you're married, you must name your spouse as your 401(k) account's beneficiary (unlike an IRA), unless your spouse signs an inheritance waiver. And if you die, your spouse can elect to get your 401(k) account's proceeds paid out over time rather than in a lump sum. You and your spouse definitely need to work with your financial planner to understand payment plan possibilities, advantages, and limitations.

As with IRAs, your 401(k) beneficiary or beneficiaries may owe income tax on distributions they receive because of the tax-deductible contributions you made along the way. Also, as with IRAs, proceeds left to a named beneficiary — your spouse or, if your spouse signs a waiver, someone else — don't pass through probate.

Social Security and your estate planning

Social Security bashing has almost become an American sport. From complaining about how much Social Security tax is withheld from our paychecks every year, to fearing that when we retire, the system may have little or nothing left despite how much tax we've paid in, Social Security gets as much respect as, well, as Rodney Dangerfield.

Not so fast, though. With estate planning (not to mention your retirement planning), don't overlook the benefits that Social Security can provide you. Specifically, your estate planning can benefit from:

- **Social Security retirement payments:** The pension portion of Social Security
- **Survivors benefits:** Like life insurance payments from Social Security that may go to your family members after you die
- **Social Security Disability Insurance:** Payments you can receive if you become disabled that help to protect part or all of your estate
- **Supplemental Security Income:** Additional money available from Social Security for the truly needy

We discuss each of the preceding items in the following sections.

Social Security retirement payments

Perhaps you're getting close to your retirement years, and as you take stock of everything that your estate comprises — your bank accounts, stocks and bonds, retirement funds, home and other real estate, collectibles, and so on — you're starting to worry. You don't have a pension plan where you work, and your IRAs and 401(k) plans haven't been doing so great lately because of stock-market losses.

You sit down with your financial adviser to talk about your retirement plan and estate plan. You tell your adviser that you have specific estate-planning goals with regard to leaving certain property behind for your children and your favorite charity. You really don't want to have to sell your collectibles, sell your house, or take out a second mortgage. However, you're not sure if you have enough money available for your retirement years without having to make tough decisions that may cause you to fall short of your estate-planning goals.

TECHNICAL STUFF

You'll find a fair amount of concern about the impending insolvency of Social Security, partially due to demographics and not enough younger workers paying into the system to support current and soon-to-be retirees collecting Social Security. As in the past when Social Security has made changes, future change to benefits would most likely disproportionately affect workers younger than 50. So, if you're over 50, you could face a reduction in your benefits if the system runs out of money as projected in the 2030s. However, a reduction in benefits should not mean zero benefits!

Depending on factors such as how many years you've been working, your income, and the age at which you expect to retire, the average Social Security monthly payment is approximately $1,650 at full retirement age (FRA), with a maximum monthly payment of approximately $3,300 based on 2022 government calculations. Inflation will adjust those payments upward, though, so you can always check the Social Security Administration website (`www.ssa.gov`) for the latest figures and your own personalized up-to-date retirement benefits estimate.

WARNING

One of your biggest retirement decisions will be when to start receiving Social Security payments. This can be as early as age 62, at FRA of 66 to 67 (depending on when you were born), or delayed until you're 70. Layered on top of this decision are income caps; if you make more than a certain amount and take Social Security before your FRA, your Social Security benefits are actually *reduced!* When you begin to receive Social Security makes a big difference when it comes to how much you'll receive — forever. Receiving Social Security payments early at 62 reduces your payment to approximately 70 percent of your FRA payment amount, while delaying until age 70 increases them approximately 24 percent to 32 percent (depending on when you were born) above your FRA amount. This can have a profound impact on your retirement plan and, ultimately, your estate plan. Do not make this decision lightly or make the mistake of thinking "The sooner the better" when it comes to receiving Social Security payments. For some people, taking Social Security early at 62 is the right financial decision. But for others, it's a big financial mistake.

From a retirement-planning perspective, you certainly want to factor Social Security income into other retirement income and, balancing that total against anticipated regular expenses, travel, and so on. More important, though (for purposes of this book, anyway), your Social Security retirement payments operate similar to a company-provided pension plan — money for your retirement years that supplements other income you have or amounts that you draw from your savings. Depending on your retirement-versus-estate philosophy, you can either:

- Have more money available to use during your retirement years.
- Draw less from your savings and assets to fund your retirement, thus leaving more available for your beneficiaries after you die.

For many people, Social Security retirement payments augment pension plan income or withdrawals from savings and IRAs and often are enough to cover routine and even some unanticipated expenses. For you, these payments may mean that you don't have to sell collectibles and antiques that you want to leave to your children, or sell the family home that you want to keep until you die and then leave behind for your spouse or perhaps one of your children.

So, even though you may think of Social Security retirement payments only in the context of retirement planning, remember that Social Security also affects your estate planning because you use less of your savings and investments to cover expenses during your retirement years.

Survivors benefits

A significant portion of your estate plan is figuring out who gets what. You want to designate who gets property that you currently have. And as we discuss in Chapter 17, you can use life insurance to create money to go to one or more beneficiaries after you die.

Another piece of the who-gets-what picture also comes from the Social Security corner: survivors benefits. Survivors benefits provide payments to certain family members, such as spouses (widows or widowers), children, and dependent parents.

TECHNICAL STUFF

Even certain divorced spouses may qualify for survivors benefits. For example, if you were married for at least ten years and then divorced, your former spouse may be eligible for the same benefits as if you were still married when you die. Even if you were married for a shorter time, your former spouse may be eligible to receive survivors benefits if they're caring for your child who is under the age of 16.

Essentially, survivors benefits act in much the same way as life insurance (see Chapter 17). However the amount of money that Social Security provides probably won't be enough to maintain your family's quality of life without causing a serious impact on your estate — specifically, forcing your family to sell property that you left them that they had planned on keeping.

TIP

Make sure you include your Social Security benefits with your private insurance benefits when you're looking to take care of your family and protect your property when you die.

Social Security Disability Insurance

REMEMBER

In Chapter 17, we discuss how long-term disability insurance can be an important part of your estate planning. Long-term disability protects property in your estate by providing income if you become disabled (therefore, preventing you or your family from having to sell much or all of your estate to make up for lost income).

In addition to long-term disability insurance that you purchase from an insurance company, you may also be eligible to receive Social Security Disability Insurance (SSDI) payments (depending on how many *credits* you build up during your working years — consult the Social Security Administration for more information). SSDI payments provide a modest amount of money to help pay for expenses and can help protect your estate by allowing you to avoid selling off property that you'd like to keep — at least for a while, assuming you have enough money coming in from SSDI and any long-term disability insurance that you purchase.

TECHNICAL STUFF

If you become disabled and begin receiving SSDI payments, you do so until you reach the age of 65, at which time those benefits automatically convert to Social Security retirement benefits — but you still receive the same amount of money.

From an estate-planning perspective, SSDI benefits help protect your estate, but they most likely don't come close to covering your living expenses (and, if applicable, your family's living expenses). Therefore, to help protect your estate, don't forget about long-term disability insurance before you need it (see Chapter 17 for details).

Supplemental Security Income

Supplemental Security Income (SSI) is a Social Security program that provides benefits to the truly needy — people who have very little property, who are blind, or who have other disabilities.

From an estate-planning perspective, SSI comes into play as sort of a last resort if the most unfortunate, tragic circumstances come to bear in your life and all your estate planning has gone down the drain. If you've had to sell all the property in your estate because of some unfortunate turn of events, you can at least turn to SSI for some amount of subsistence.

Nobody really plans for such a turn of events in life, and certainly if your circumstances are such that you need to apply for SSI, almost everything else that we discuss in this book is irrelevant. However, in the interest of completeness with regard to our Social Security discussion, we at least want to mention SSI so you know the program is available if the worst comes to pass.

KEEPING TRACK OF YOUR SOCIAL SECURITY BENEFITS

The Social Security Administration used to send statements detailing your benefits. They stopped mailing statements in 2011, and now paper statements are only mailed if you're 60 years old and haven't set up an online account (this was the reason they stopped mailing — they wanted to encourage people to set up online accounts.) Not only is your online account password protected, but it requires *multifactor authentication* (MFA), a security feature that requires you to confirm your login via a text message or email message sent to you.

To set up your account, visit `www.ssa.gov`. Your online account is updated annually because Social Security benefits are increased annually to reflect inflation. Your account will show you lots of information, including:

- Your adjusted gross income (AGI) each year you've been working.
- The amount of your AGI subject to Social Security taxes. (If you've earned more than the maximum taxable amount, only some of your adjusted gross income is subject to Social Security taxes.)
- The amount of Social Security taxes withheld each year from all your paychecks that, essentially, comprises your personal Social Security account.
- Your taxed Medicare earnings.

The website also provides you with a projection from the SSA of the amount of money you can expect to receive each month, with various scenarios depending on the year in which you elect to begin receiving Social Security payments. The current format is a graph you can move at any point between receiving payments early (62 years) and delayed (70 years) and it will show your monthly payments under all scenarios. As discussed in this chapter, the earlier you start receiving payments, the less you get each month; conversely, the longer you wait to start receiving payments, the more you receive each month. (The projections are based on assumptions of your annual earnings between now — the date of the statement — and when you retire and are only estimates.)

Be aware of all kinds of rules that not only govern how much you receive, but also affect additional Social Security benefits (such as for disability), what happens if you or your spouse dies, what happens to your benefits if you get divorced, and whether your Social Security payments are taxed (depending largely on your additional earnings). You can get details of these and other aspects of Social Security from various publications that describe your benefits in detail, as well as from the SSA's website (`www.ssa.gov`).

IN THIS CHAPTER

- » Dealing with divorce and children from multiple-family situations
- » Understanding the rules for unmarried cohabitants
- » Identifying the complexities of guardianship
- » Looking at durable power of attorney and the living will
- » Including your pets in your estate plan

Chapter 19

Estate Planning in Exceptional Situations

Even the most orderly estate plans can be cast to the winds by some unforeseen event. Don't despair! Not only is estate planning about putting together an orderly, comprehensive strategy to address your will, estate taxes, insurance, and all the rest, but also it's about planning for the unplannable.

Take divorce, for example. Most of estate planning is built around and based on traditional family structures: a never-before-married couple that stays married for their entire lives and has two biological children. Just thumb through the pages of this book and notice how often we refer to "your spouse" or "your children." We're simply reflecting the fact that laws governing estate-related matters, such as those for wills and taxes, focus primarily on the traditional family structures most common when those laws were first written.

But if your family or personal situation doesn't look like the Cleavers from the 1950s show (and all-time-favorite cliché) *Leave it to Beaver,* this chapter is for you. The traditional so-called "nuclear family" composed of a married couple with children today represents only 18 percent of U.S. households or less than one in five families. (This segment has decreased from approximately 40 percent in the 1970s.) In this chapter, we discuss how divorce, unmarried couples (either same sex or opposite sex), and incompetence (in a legal sense, not "being unable to get the hang of something") can affect your estate planning.

You have two main choices: You can do nothing or you can do "something else." We explain what happens if you choose to do nothing — leave your estate's fate in the hands of relevant laws — as well as the specifics of that catchall "something else" to better match your estate-planning goals.

Working a Divorce into the Plan

When divorce happens to anyone who is key to your estate planning — you (and, by extension, your spouse), your former spouse, your children, your parents, your brothers or sisters — everything becomes unsettled as the divorcing couple divides up their property. Unfortunately, most people in the middle of a divorce focus on the present instead of the future — how marital property is divided, for example, or (in less congenial divorces) how much of the other person's property they can grab as part of the divorce settlement.

In the following sections, we discuss your choices for two important parts of your estate — and your life — that divorce affects: property and children. We describe:

- What's likely to happen if you don't do anything
- What your options are if you decide to do something

TIP

You may want to work with an attorney who specializes in divorce in addition to your estate-planning attorney, who may not do much divorce work. However, you need to make sure that these two attorneys coordinate their activities and that you clearly understand what each is doing (or trying to do) and how particular tactics affect your estate planning. Make sure that one attorney doesn't inadvertently negate something important that the other attorney has created, affecting your desired outcome.

Divvying up the stuff — and ignoring the estate plan?

When people divorce, they divide up their property.

"No kidding," you're probably thinking. Even if you've never gone through a divorce yourself or know someone who has, you've probably seen hundreds of TV shows and movies in which two people getting divorced go through the exercise of deciding who gets what.

Very often, though, people going through divorce focus primarily on the here and now of dividing up property and don't really consider the impact on each person's estate planning.

WARNING

A divorce is an emotional time for all parties. That said, you need to coolly and carefully look at every decision with respect to divvying up your property as actually being *two* decisions, not just one:

- How does a particular decision impact you in the here and now, which is the emotional portion of your decision-making.
- How does that same decision impact you in the future — your estate planning — which is the nonemotional portion of your decisions-making.

If you don't take both portions of your decision-making into account, you could be making a less-than-desirable decision focusing on the here and now (and your divorce) that may negatively impact your estate plan in the future.

Look at it this way: Before you divorce, you have an estate plan that thoroughly covers property you jointly own with your spouse, as well as your own individual property. Your spouse has a similar estate plan. Most likely, you and your spouse plan to leave most, maybe even all, of your respective estates to each other. You also have plans for your children, plus maybe each person's siblings, parents, nieces and nephews, and so on.

But after you divorce, both you and your spouse are back to square one. One way or another, your property has been divided — perhaps 50 percent to each of you, or maybe 95 percent to one spouse and only 5 percent to the other — meaning that the total value of each person's estate has now changed. Individual items (for example, tangible personal property, such as an antique grandfather clock) that you may have included in your will may now belong exclusively to your ex-spouse.

In this section, we discuss how divorce affects your estate planning if you do nothing and let state law run its course, as well as if you take a more active role.

Figuring out what happens to your property if you do nothing

Married people usually think in terms of "our property" rather than "my property and their property." They fill out applications for car loans and mortgages and include all family assets and debts regardless of whose name a brokerage account is in or who really owns that coin collection tucked away in the safe. In fact, estate planning is often the first time married couples take a hard look at how much of "our property" is really "our property" (that is, jointly owned marital property) and how much actually belongs solely to one spouse or another.

But if divorce happens, then suddenly the long-standing view of "our property" goes out the window. Claims and accusations of "You never liked that Tiffany lamp anyway!" and "I used my money to buy the vacation home!" often start to fly, and the more adversarial a divorce becomes, the more contentious the process of dividing up the property.

WARNING

Depending on various state laws, divorce can cause ownership rules to change, which not only complicates the divorce process but also later affects the estates of each person.

For example, suppose that a husband purchases a cabin at a lakefront lot as a getaway for him and his poker buddies, and keeps the property titled in his name only. He is free (in most states) to later sell the property without having to include his wife in the transaction. Similarly, if a wife purchases a condo in Vail where she goes to have some quiet time to write books and articles, and if the condo is titled only in her name, in most states she can later sell that property without her husband getting involved in the sale.

TECHNICAL STUFF

However, if the couple goes through a divorce, the rules change. Specifically, the concept of *marital property* comes into play, meaning that property acquired during marriage is considered to belong to both parties to one degree or another. In *community property* states (see Chapter 4), the law applies a fixed ownership percentage to property acquired during marriage (typically 50 percent for each), regardless of whose money is used or other factors. In other noncommunity property states, the courts determine the ownership ratio of each spouse in an attempt to create a fair and equitable distribution of marital property. The bottom line: Property that a couple acquires during their marriage probably is split up in some way if they divorce, with the courts and state law making the divisions. The "control" portion of this part of your carefully crafted estate plan is out the window.

After the divorce is settled, the estates of both former spouses have been "shuffled" and the "who owns what" picture for what was once marital property is changed.

In most states (including community property states), property that each spouse owned before getting married doesn't become marital property at the time of divorce. That means if the couple divorces, each person keeps what they originally had (before the marriage) within their respective estates after the divorce is finalized. Basically, you have sort of a postmarital twist from a lovey-dovey, ever-optimistic, "what's mine is yours" to "what's mine is mine."

WARNING

However, you need to be aware of a potential complication: If the property that each spouse owned before the marriage has appreciated in value during the marriage, the appreciated value usually will be considered to be "marital property" subject to court division. And with recent years of significant increases in the *real property* (housing and real estate) market, very likely your overall estate value has appreciated, sometimes significantly. If the marital property cannot be divided in kind along with available liquid assets (cash, bank accounts, and so on) to achieve the required equitable split, the court may be required to sell assets (including appreciated assets acquired before marriage) in order to achieve the necessary division.

WARNING

Ownership of property often changes automatically when two people divorce. In states where a married couple can own assets as joint tenants with the right of survivorship or as tenants by the entirety (see Chapter 6), the ownership usually changes to a common ownership after a divorce. So, whereas before the divorce when one spouse would automatically acquire the full ownership after the other died, the rules have now changed. Now, because the ex-spouses own a common and equal interest with the other but without the right of survivorship, each person's ownership percentage of the property becomes part of their respective estates. Furthermore, those assets, like any other probate assets (see Chapter 5), will be subject to each person's will (or if none, the intestate laws of the state).

TIP

After a divorce, you must at least take the following steps concerning the estate plan:

- Revise or overhaul any estate and gift tax marital deductions.
- Prepare a new will to reflect your new marital status and remove any property you no longer own as a result of the divorce settlement from your will's giving clauses (see Chapter 3).
- Make new arrangements for the transfers of your property after your death. (You need to revise your beneficiaries so your ex-spouse doesn't receive any of your property unless you still want your ex-spouse to receive some of your property.)

Getting more proactive: Additional options for your property

After your divorce is finalized, your ex-spouse is just like any other unrelated person with regard to your estate planning. Suppose, though, that your divorce was a particularly congenial one, and you and your spouse get along very well as you both continue to play important roles in your children's lives? Suppose you remain good friends and you want your former spouse to receive part of your estate after you die?

If that's what you want to do, then nothing is stopping you! You just need to explicitly mention your former spouse in your new will (or trust) and the property that you want to leave them, just as you would your best friend from college, your next-door neighbor, or any other unrelated person.

Looking at marital agreements

You can also use a *marital agreement* to make legally binding arrangements for additional out-of-the-ordinary property transfers that affect your estate and that of your former spouse. (You can specify that certain assets will go to your former spouse.)

MARITAL AGREEMENTS AND YOUR ESTATE

You probably recognize a marital agreement by the more common nickname of *prenuptial agreement,* or prenup for short: a marital agreement that is signed before you marry. However, nothing prevents you and your spouse from entering into a marital agreement after you marry, thus creating a *postnuptial agreement.* The latter agreements are often overlooked but should be carefully considered as part of your estate-planning documentation, especially where there are waivers in the rights of one party.

You may also come across the term *ante-nuptial agreement,* which is another way of referring to a prenuptial agreement that is created before you marry.

Whether the marital agreement is a prenup or a postnup, its terms and provisions represent the wishes of both parties and are governed by state law. The primary purpose is to establish property rights of each spouse, now and in the future. The marital agreement customarily establishes who owns what assets. If any assets are considered to be marital assets, the marital agreement will specify how those assets are to be divided between the parties at death or upon the termination of the marriage.

TIP

Couples also often use marital agreements to specify who won't get what if a divorce occurs.

An important part of many marital agreements is the *waiver* of the right of the parties to share in or claim a right in the estate of the other, now, upon divorce, and at death. Each person usually expressly gives up the right to participate in the other's estate or to claim any property rights in the other's estate. The parties to a marital agreement also are free to create nonprobate assets, such as joint tenancy with right of survivorship (see Chapter 6) that are held jointly or by only one of the spouses along with one or more other people, or to make outright transfers to each other, to children, or to other third parties.

WARNING

State inheritance taxes can become an issue if you leave property to your former spouse. You need to know if your state has an inheritance tax with different rates depending on the relationship of the beneficiary to you. State inheritance taxes vary widely among the states. If you're still married, your state may have no inheritance tax or only a small inheritance tax percentage, but if you're divorced, a much larger percentage for someone who isn't related to you, such as your ex-spouse.

A common concern of divorced people is deciding how to honor moral agreements and obligations from their married days. Very often, these moral issues can conflict with the expectations and the legal rights of your current spouse and family (if you remarry). And even if your current spouse decides to go along with your previously made plans, the law in your state may dictate otherwise.

Suppose, for example, that you and your former spouse had an understanding while both of you were alive that whoever died last would leave a specific (and large) amount of money — let's say $750,000 — to a certain charity. Suppose also that your spouse died first, but you remarry. Finally, suppose that for whatever reason you don't have enough money when you die to make that $750,000 gift without adversely affecting the welfare of your new spouse and your children or stepchildren if you die before your new spouse does.

In Chapter 4, we discuss how noncommunity property states typically have will statutes that govern *spousal elective shares* (essentially, the right for your spouse to receive at least a minimum amount of your estate even if you've specified otherwise in your will). Most likely, your new spouse can exercise their right to receive that minimum amount, even if that means not enough money is left for your intended $750,000 charitable gift.

TIP

Your solution: If you want to honor some type of moral issue or obligation from a prior marriage, especially if that obligation involves property transfers after you die, work with your attorney to set up the appropriate type of trust (see Chapters 7, 8, and 9). You can create a trust that benefits both surviving family members and a charity (or charities) to one degree or another. Trusts may seem complex, but they can accomplish many goals for your estate planning.

Considering children and divorce

One of the most tried-and-true recipes for bad TV movies (particularly back in the '70s and '80s) involved a second or third marriage, children from a previous marriage as well as a current marriage, and "broken promises" (or at least a change in plans) regarding who would inherit what property after someone died. The scheming and double-crossing, the yelling and screaming . . . yeah, those were the days.

In real life, unfortunately, the most contentious issues regarding estate planning and subsequent marriages often arise from that very same recipe. In order to prevent your life from turning into one of those TV movies, you need to take a particularly close look at how your remarriage affects any planned property transfers to your children from a previous marriage. Many families today have mix-and-match situations: biological children (that is, the family's husband and wife are the children's biological parents), stepchildren, and adopted children from either spouse's prior marriage(s).

TIP

Before you walk down the remarriage aisle, you have something much more important to think about than the honeymoon. Note that we said *before,* not after. You need to focus on the potential changes your remarriage will require for your existing retirement plan and estate plan. New stepkids? Less assets from the division of property from your divorce? As great as the honeymoon can be, this short-lived experience should be secondary to focusing on the changes that may come about in your financial plan, retirement plan, and estate plan. Remarriages can be challenging enough with lots of ex-spouses and children; with enough preplanning, however, your estate plan should not be part of this challenge.

WARNING

Just because you have a household that contains, say, eight children, all children may not be treated equally or fairly in inheritance and other estate-planning matters, because of those children's respective relationships with you and your spouse.

Therefore, you need to be aware of two considerations:

- How applicable property transfers normally occur as governed by law, and how some children may find themselves cut out of inheriting property
- The ways you can change the normal order of property transfer to better meet your needs and desires and treat children from various marital combinations more equitably

Discovering what happens with your children if you don't adjust the estate plan

In *first families* (that is, ones in which neither spouse has ever been married before), wills tend to be relatively straightforward. (Intestate laws are also straightforward regarding who is involved — spouses get something, children typically get something, and so on.) However, if a spouse in a *subsequent marriage* (a second marriage, third marriage, and so forth) dies *intestate* (without a will) the state's intestate laws get a bit more complicated. Complications typically include the following:

- The stepchildren of the spouse who dies (that is, the non-blood-related children who aren't adopted by the person who just died) likely won't receive anything under intestate laws.
- If most or all of the just-deceased person's assets are held jointly with their spouse in this subsequent marriage, then little or nothing is available to go to that deceased person's children from a prior marriage, even if that had been the plan all along after getting remarried.

Continuing with the example, if the surviving spouse later dies without a will, intestate laws will likely transfer that person's property to their children — including property that was once owned by that person's deceased spouse — meaning that the prior deceased spouse's children probably get nothing! This is another example of the importance of the "control" part of estate planning through legal documents.

Even with valid wills that keep intestate laws at bay, children from multiple families complicate matters. Suppose each spouse has a will, and both wills provide for some mutually agreed equitable distribution among all the children from all family combinations: one spouse's children from a prior marriage, the other spouse's children from a prior marriage, and their joint children from their current marriage. But suppose one spouse dies first. What prevents the surviving spouse from changing their will afterward to cut out the deceased spouse's children? Nothing!

Adoption also changes the complexion of your family, forcing changes in your estate planning. Basically, when you adopt someone, that person (the *adoptee* in legalese) is considered to be in the same position within your family as any of your biological children.

So, if you adopt a child — it doesn't matter whether that child comes from an orphanage across town or from another country, or is the biological child of your new spouse in a subsequent marriage — the law treats the child the same as if they were born to you. Furthermore, the court no longer considers the child to be a member of their former family.

For example, suppose you and your spouse are each in your first marriages, and the two of you have three biological children. Then, together, you adopt a child. If your will specifies that you're leaving $400,000 to be divided equally among all your children, then each child — your three biological children *and* your adopted child — will receive $100,000.

In contrast, your adopted child has no claim on their biological parents' estates.

Making different choices for children and your estate

You can override inheritance laws for various parent–child relationships (biological children, stepchildren, and so on) if you want. In order to do so fairly easily in your will, you can use estate-planning mechanisms, such as trusts and life insurance death benefit proceeds (see Chapter 7 on trusts and Chapter 17 on life insurance). However, as we point out earlier in this chapter, you need to think ahead — particularly for stepchildren and adopted children — and consider how to counter any possible complications, such as your surviving spouse changing their will after you die to cut out your children from your first marriage. Here are some general approaches you can take:

- **Use gifts.** If your estate-planning strategy includes giving gifts to your children (and possibly other people), you can also give gifts to your stepchildren. As we discuss in Chapter 11, you can make tax-free gifts by keeping the amounts of those gifts below the gift tax radar (the annual exemption amount). Plus, you have the added benefit of giving while you're around and seeing the joy the gift brings them (this will more than make up for the wrong holiday gift you bought your child that they haven't let you forget about.)

ESTATE-RELATED TAXES AND STEPCHILDREN

As a general rule, estate-related tax issues are the same no matter if you're talking about a first marriage or a subsequent marriage, except for a few complications. One possible complication you may have is tax treatment on assets passing to stepchildren, as contrasted with your biological children or adopted children (including the children of your new spouse from their previous marriage or marriages). Make sure to work with your attorney to understand laws and rules relating to transferring property to your stepchildren, particularly at the state level if your state's inheritance taxes apply where you live, particularly if different tax rates apply depending on the relationship between you and various recipients.

- **Be explicit in your will.** If you want to include stepchildren on an equal footing with biological and adopted children, use specific provisions in your will (see Chapter 3) to explicitly specify what property you want each to have. If you want to be absolutely certain that property in your estate goes to your children — biological children, stepchildren, or adopted children — then you must leave that property to them directly rather than indirectly (for example, leaving the property to your current spouse who then is supposed to leave any remaining property as part of their will to the children). There is no such thing as being *too* explicit, so lay it all out there in detail.

  WARNING

  Life and circumstances can change. You want your wishes to be carried out regardless of changes in your loved ones' lives. Suppose your second spouse gets in a fight with one of *your* biological children after you die, and now, playing the clichéd role of Evil Stepparent, they want to cut your biological child out of the estate that you left your widow with your wishes that they would leave something to your biological children. It's imperative to make sure your intentions are iron-clad in your estate plan so nothing can negate your intentions with respect to your beneficiaries.

- **Use trusts.** If appropriate, set up trusts with property earmarked specifically for one or more of your children, even including stepchildren.
- **Use marital agreements.** You can use prenuptial, postnuptial, or any other type of marital agreement to obligate your spouse to honor agreements that the two of you make to take care of each other's children, even after one of you dies.

Planning for Unmarried Relationships

As we mention at the beginning of this chapter, much of estate planning — will statutes, tax law, and so on — is oriented toward traditional legally married relationships (whether opposite sex or same sex). If you're involved in an unmarried relationship, how is your estate planning affected?

Unless a valid common-law marriage can be proven, *unmarried cohabitants* — that is, people who live together — don't usually have the benefits or obligations of a conventional marital relationship. However, some exceptions do exist. For example, the concept of *palimony* (basically, "alimony for unmarried couples") is recognized in some states. Keep in mind, however, that any palimony rights are based more on the relationship itself rather than on any finding if a "marriage" exists between the parties. But because palimony rights do create and affect property rights, they must be recognized for the rights and obligations they create.

SPECIAL NOTES FOR SAME-SEX COUPLES

WARNING

You may find a couple of wrinkles that same-sex marriage partners need to be aware of with respect to estate planning. First, any estate planning documents entered into prior to the 2015 legalization of same-sex marriages should be carefully reviewed and updated as needed. For example, if you established a domestic partnership in a different state because your state didn't recognize your relationship, and you have since ended that relationship, some states automatically turned domestic partnerships into legally recognized marriages. Congratulations! You are now legally married to someone who you are no longer with that could make a claim on your estate. Hence, the review of all things legal you entered into prior to 2015.

Prior to the legalization of same-sex marriage, one partner could leave any amount of their estate — say, 15 percent — to their partner without having to deal with required percentage shares of an estate under the law. This all changed with the legalization of same-sex marriages, which are now required to leave a certain percentage of their estate (50 percent in a community property state, for example). Older agreements may need to be updated. Take all these details into account with respect to estate planning, knowing that there are legal requirements for a share of your estate.

A valid common-law marriage involves a couple that considers themselves spouses with the intent to be married, even though they've never had a civil or religious ceremony. If a court recognizes their relationship as a common-law marriage, both people are entitled to the same rights and are subject to the same obligations as any married couple.

Note: Just because a couple lives together for a while doesn't mean they have a right to a common-law marriage. Generally, a court finding determines that a common-law marriage does or did exist. In fact, the court normally becomes involved after a possible common-law marriage has dissolved, when one of the parties tries to establish property rights or some other rights relating to the relationship.

For the most part, we advise against common-law marriages. If you intend to get married, do so. Otherwise, even if you and someone else live together, don't try to treat an unmarried relationship the same as if you were married. Otherwise, you may face a palimony situation. Or you may require a divorce to legally terminate a common-law marriage.

However, you may be involved in an unmarried, cohabitating relationship with someone — either same-sex or opposite-sex — in which you and the other person want to provide for each other in some way as part of your respective estate planning. If so, you must work with your attorney (or attorneys, if you have your own attorneys) to properly and adequately establish your respective estate plans. This is vital to make sure that all parties are on the same page and can help avoid future disputes when you die.

First and foremost, make sure that each of you has a will in which you very explicitly refer to the other person and you also very clearly specify what you want to leave to that person. Or perhaps you each want to leave your entire estate to the other. The choice is yours — just make sure you factor any such plans in with other beneficiaries.

TIP

If you want your partner to receive the house that you share, or any other particular property, rather than leaving it to any of your blood relatives (children, siblings, parents, and so on), you may use the joint tenancy with right of survivorship form of will substitute (see Chapter 5). Remember that property owned as joint tenants with right of survivorship passes outside of probate, so property — such as your house — is less likely to get tangled up in legal dealings or challenges from disgruntled relatives who may want to stake a claim to that property.

You can also use trusts and other estate-planning vehicles to establish plans for each other. For example, you may set up a trust that provides periodic payments to your partner for some period of time after you die. You also have life insurance proceeds (see Chapter 17) as another means to provide money to your partner.

WARNING

If you don't have a will, and if you don't adequately use proper will substitutes or trusts, you run a very high risk of not being able to transfer property to a partner in an unmarried relationship! Remember that intestate laws govern property transfers for your probate estate that you haven't included in a valid will, meaning that the state decides what happens to your estate and who receives it. Trust us, your estate isn't likely to go to your unmarried partner, no matter what the two of you have agreed, no matter how committed your relationship was, or any other factors! So, make sure to work closely with your attorney to adequately and thoroughly set up your estate plans to accomplish your wishes.

Untangling the Complexities of Guardianship and Your Estate

Guardianship is an essential part of estate planning that people often overlook as they concentrate on more quantifiable aspects, such as the property in their estates or estate-related tax planning. But you do need to understand two different types of guardianship: for your children and for yourself.

Guardianship for your children

Most people recognize the terms *guardian* and *guardianship*, at least when it comes to deciding who will watch after their children if both parents die while the children are still young.

You need to give careful thought to issues of guardianship as part of your estate planning, too.

One of the most common guardianship-related decisions relates to your minor children. By federal law, the *age of majority* is considered to be 18, and until a person reaches that age, that person is a minor. Under normal circumstances, a minor's parents provide and make almost all the decisions. However, two main types of guardianship may come into play if normal circumstances cease to exist, such as if both parents die.

TECHNICAL STUFF

You actually need to consider two different types of guardianship: *guardianship of the person* (the care-and-decisions form of guardianship) and *guardianship of the estate* (in which someone is appointed to specifically control the minor's property, but not necessarily provide care to and make decisions for the minor). Guardianship of the person is the aspect of guardianship that most people are at least somewhat familiar with. A minor becomes a *ward* of their guardian and typically goes to live with that person. However, the second, less familiar form — guardianship of the estate — exists when a person or some entity (such as a bank's trust department) has the responsibility to invest a minor's money, watch out for the minor's assets, and generally take care of that minor's property until some point in the future.

TIP

Depending on the person you trust with guardianship, you have to do an honest, deep-dive assessment of their skill set as it relates to the guardianship. For example, most people immediately think of appointing a guardian based on who they think will best take care of their minor child. But this person as guardianship of the person may not have the skill set (such as financial acumen or background) to also be appointed as the guardianship of the estate. This latter guardianship is someone you implicitly trust to do what's right in the financial welfare, *not* the nurturing welfare, of your minor child. These are two different skill sets that may not overlap in your guardianship selection. So, it's perfectly fine, and sometimes even advisable, to separate and appoint different persons to the guardianship of the person and the guardianship of the estate.

When a minor reaches the age of majority (again, 18), the need for guardianship ends, and the former minor can now legally make decisions, live where they want, and generally live as any other adult would. The guardian then simply turns the assets over to the former minor unless court approval is required. In this case, the guardian files an accounting of their activity and, after receiving court approval, turns everything over to the minor.

WARNING

Until that point, however, you need to be sure that care will be provided for the minor. And if the minor in question is your child — which most likely means that you died while your child was still young — then you hopefully have made provisions in your estate plan for your child's guardians. If not, the courts appoint a guardian, which may not be the person or institution that you would choose. So, why leave things to chance? Make sure to adequately take care of guardianship as part of your estate planning along with your property, insurance, taxes, and all the rest! Guardianships are sometimes afterthoughts in the estate-planning process because we can't imagine not being there for our children. Don't make this mistake. The guardianship of the person and the guardianship of the estate are very important decisions to make. Even though you hope to never have to use them, spend the time thinking about how to protect your children in the unfortunate case you need to.

Guardianship for yourself

Suppose you aren't able to adequately take care of yourself or to make decisions, possibly as a result of advanced age or in the aftermath of a serious injury? What happens then?

IF YOUR KID HAS A LOT OF WILD OATS LEFT IN THEIR BAG

If you're worried that one of your offspring may not be able to handle their inheritance until sometime after age 21, no problem. Other avenues are available to control and protect those assets. You can put the assets in trust, for example, and keep them there for as long or short a period as you think is necessary.

Leaving any amount, let alone a large amount, of an inheritance to your children may be a lot for them to handle without the proper skill set that they may not possess. Buying an expensive car or a house are two situations where your offspring may not be ready for financial responsibility. Instead of leaving everything to be inherited at one time (such as on their 21st birthday), think about spreading out their inheritance over a period of time (for example, 20 percent of the inheritance distributed every few years or 50 percent of the inheritance not distributed until they turn 30 years of age and are more mature and fiscally responsible). This spreading out of their inheritance can help prevent them from losing it all due to a lack of financial acumen. Additionally, if something is important to you, such as your children receiving an education after high school, you can stipulate that certain benchmarks must be achieved before an inheritance is distributed to them — sort of like reaching beyond the grave to make sure your kids still get an education to become a self-sufficient person beyond their inheritance.

As we discuss in the next section, you may have a guardian yourself: someone who the court appoints to look after your best interests, much as a guardian is designated or court-appointed to look after your child's interests.

WARNING

However, as we discuss, guardianship is only one option you have when dealing with situations where you can't adequately care for yourself or aren't capable of making decisions. You can consider other mechanisms — a durable power of attorney and a living will, specifically — as part of your estate planning. (See the following section for more on power of attorney and living wills.)

Doomsday Stuff: Factoring Incompetence and Death into Your Plan

You need to plan for what will happen to your estate if you become incapacitated or incompetent and the choices you have for how your care will be provided. Furthermore, you need to think beyond incompetency and incapacity and consider what may happen if you're about to die. As described in this section, you need to be aware of adult guardianship issues, but you also need to complete a *durable power of attorney* and a *living will* as part of your estate planning.

WARNING

Cognitive impairment is a risk that needs to be taken into consideration in your estate planning. Cognitive impairment is much more serious than occasionally forgetting where you put your keys! Many people think of cognitive impairment as dementia or Alzheimer's disease. But what if you have some other kind of cognitive impairment and you're unable to make basic decisions regarding your estate as well as your own care?

How common is some form of cognitive impairment? The American Academy of Neurology estimates that mild cognitive impairment is present in 8 percent of people ages 65 to 69, but the number jumps to 25 percent of people ages 80 to 84. If you're fortunate enough to exceed the average life expectancy and live beyond the age of 85, the chance of cognitive impairment increases to almost 40 percent. And remember, this is *mild* cognitive impairment. The World Health Organization estimates that 50 million people worldwide have dementia, with 10 million new cases added each year. As we live longer, we increase the chances of developing some form of cognitive impairment, so planning for this possibility is critical.

REMEMBER

The three basic documents that everyone needs to have as part of a thorough estate-planning effort are a will (see Chapter 3), a durable power of attorney, and a living will.

A durable power of attorney: Your personal representative while you're alive

In general, a *power of attorney* is a document by which a person appoints someone else to act as their agent to do one or more acts. The powers granted can be limited or pervasive, can continue indefinitely or can terminate at a particular time, can be effective immediately or at some future time or upon the happening of some event (such as incapacity), and generally authorize another to do all or only some of the things the person can do themselves.

A *durable power of attorney* is one that continues to be valid and enforceable even after the person making it becomes incompetent or incapacitated. The durability power is required in order to help avoid a guardianship proceeding in the case of incompetency. It allows the agent to continue to act for the incompetent person.

As compared with guardianship, a durable power of attorney has several advantages, such as the following:

- The agent (again, the person in control) can usually act on most matters on behalf of the incompetent person without court approval.
- No regular court filings are required.
- Matters are more private and less embarrassing.
- The agent is chosen by you and not by the court.

If an agent is unable to continue to serve under a durable power of attorney, a family member or some other interested party can always request the court to appoint a guardian at a later time, even if the incompetent person's care started out under a durable power of attorney.

A durable power of attorney usually is one of the following forms:

- A *general* or *business power,* which allows the agent to carry on the day-to-day affairs of the incompetent
- A *health-care power,* which allows the agent to make health-related decisions for the incompetent

These two powers can name the same or different agents.

WARNING

You need to have a durable power of attorney as part of your overall estate planning along with your will, trusts you set up, your tax planning, and all the rest. If you suddenly become incompetent and don't have a valid and proper durable power of attorney, the court may have no alternative but to appoint a guardian for you with all the associated costs, cumbersome processes, and lack of privacy.

TIP

Think of your durable power of attorney in the same context as your will and court-appointed guardianship in the same context as your state's intestate laws. You absolutely want to create a durable power of attorney and a will so the court doesn't have to appoint a guardian or your state's intestate laws don't come into play.

Just as with your will and every other legal document, you can execute a power of attorney only if you're legally competent at the time. If you are, in fact, incompetent, a power of attorney you attempt to execute will likely be considered invalid even if you can physically sign your name.

Your competency and the validity of the documents you've signed may become an issue in a later guardianship proceeding or other legal action brought by a family member or some other interested party.

WARNING

The durable power of attorney needs to be established *before* cognitive issues show up. Otherwise, someone may challenge the power of attorney based on a lack of *testamentary capacity* (the proper mental state) to have established the power of attorney. For example, if your spouse develops Parkinson's disease and has a very slow cognitive decline, you don't want to have a fight with them over the establishment of a durable power of attorney, which could lead to hurt feelings and marital strife because you now see the need to take control of financial decisions, but they do not.

The living will: Giving directions when you can't communicate

In a living will, you express your wishes that certain care be provided or not provided when you aren't able to make those decisions for yourself. Usually a living will directs doctors, hospital staff, and nursing home staff to stop life-sustaining treatment that simply serves to prolong the dying process when you're otherwise in a terminal condition or death is imminent. The living will allows your wishes to be carried out when you're incompetent, unconscious, or otherwise unable to communicate. This includes providing a medical directive of do not resuscitate (DNR) in the case of serious medical peril.

The living will is usually coupled with a durable power of attorney appointing someone to act as your agent. Essentially, you use the durable power of attorney to determine who acts on your behalf to execute the instructions contained in your living will.

WARNING

Like all powers of attorney and other documents in which a person is appointed to act for you, take care of you, or take care of your property, you need to carefully choose someone trustworthy and reliable. As with guardianships for your minor children, you have to do an honest assessment of the person or persons you choose. Even if they're family or friends, that doesn't necessarily mean they have the skill set you need if they're called upon. You also need to appoint a *successor agent* so that if the primary agent whom you've designated dies (and you don't subsequently update your living will or, for that matter, your durable power of attorney) or is unable to perform the required duties, someone else can step in to make sure that your wishes are carried out. (Just as in your will, you designate a successor agent in case your first choice can't fulfill their duties.)

Many people tend to shy away from living wills even more than regular wills (see Chapter 3). Perhaps many people can't deal with the thought of the last days of a terminal illness or a catastrophic accident. Maybe they view these thoughts as more troubling than death itself and the subsequent considerations, such as how property will be distributed. Regardless, don't ignore the importance of having a living will as a part of your estate planning. Remember Benjamin Franklin's famous estate-planning quote. All right, it really isn't an estate-planning quote but both cited things relate to estate planning: ". . . in this world, nothing is certain except death and taxes."

Realizing why the court appoints a guardian when you're incompetent

What if you don't make a durable power of attorney? Who will take care of you and make decisions for you? If you do become incompetent or incapacitated, the court may appoint a guardian for you and your estate. The court wants to protect your estate from the chances of being squandered or robbed by those people with, shall we say, less than noble intentions. Additionally, the court also sees that you receive appropriate care, depending on the reason of incompetency or incapacity (for example, Alzheimer's disease, coma, and so on).

WARNING

If you don't have a living will, any wish that you have to not be kept alive by artificial means is unlikely to be carried out, regardless of whether you have a guardian. You have lost a part of the "control" you can establish with estate planning.

And, on the positive side, if your condition improves enough that you're no longer considered incompetent or incapacitated, the court will terminate the guardianship, essentially once again giving you control over your decisions and property.

LEGALESE ALERT!

Incompetent and *incapacitated* (as with *incompetency* and *incapacity*) are often used interchangeably, but very subtle differences exist that we want to point out. The difference relates to the kind of guardianship law that exists in a particular state. Under the older laws in some states, a person's competency was either so diminished as to require a guardian (in which case the person was incompetent), or if the requisite proof and extent of diminished capacity was not shown, the person was considered to be competent and the appointment of a guardian wasn't necessary.

Many states have now adopted the concept of *limited guardianships* and use the term *incapacitated* instead. In those states there can be a limited guardian or a plenary guardian, depending on the extent of incapacity. To complicate matters a tiny bit more, the term *conservator* sometimes is used to distinguish a guardian of the estate (that is, property) from a guardian of the person, who is simply referred to as the *guardian.* (We introduce these two types of guardians in the section, "Untangling the Complexities of Guardianship and Your Estate," earlier in this chapter.) As in the case of a minor, the incompetent person is the *ward* of the guardian of the person, and the property of the incompetent is simply referred to as the estate. These guardianships are highly regulated by the courts for the protection of a minor.

TECHNICAL STUFF

In legalese, the word *incompetent* has nothing to do with how the word is typically used in general conversation, as a not-so-polite synonym for *unqualified.* An incompetent person is one who can't adequately care for themselves and needs help. Incompetency can result from mental or physical problems before or during birth, later-in-life medical causes (for example, a stroke or Alzheimer's disease), an automobile accident that someone survives but leaves them in a coma for the rest of their life, or some other cause. An incompetent person can't legally make decisions for themselves and needs special protections.

Even though guardianship acts like a sort of safety net for incompetent people, drawbacks do exist. A guardian is always answerable to the court, creating a somewhat cumbersome relationship in which the guardian must file regular reports, and the court always keeps an eye on the situation. The guardian must obtain court approval before taking anything other than rather minor action on behalf of the incompetent.

TECHNICAL STUFF

Also, the guardian may be required to post a bond or other security with the court and to keep the bond current.

Perhaps the primary disadvantage is that guardianship is a legal process that requires the filing of a petition or similar pleading, with notice to all parties in interest and proof of incompetency. Quite often, these proceedings are contested and result in extensive (and expensive) litigation. Even if the proceeding is more run-of-the-mill and uncontested, it's still fairly expensive. And, of course, having someone, such as a family member or close friend, subjected to a court proceeding to determine competency can be unpleasant and embarrassing.

Taking Care of Fido and Fluffy

If you have a pet — or, like many people, more than one pet — you need to consider them in your estate plan. Most likely you won't write your will to leave the majority of your property to your eight cats, although you've probably seen those occasional human-interest (or maybe animal-interest) stories in which an elderly man dies and has made provisions for his beloved cats and dogs to live in his house for the rest of their lives, with a trusted friend or relative taking care of those pets in addition to eventually taking ownership of the house.

You can do pretty much whatever you want in your estate plan when it comes to your pets, but just as with your spouse, your children, other relatives, and friends, you need to write down everything and make sure that your personal representative and the rest of your family clearly understands what you want to happen. Just keep in mind that your pets cannot directly inherit money or property from your estate. Instead, you can leave money to a person or organization to care for your four-legged family members.

Some of what you need to specify is fairly obvious: how you want your pets cared for, by whom, and where. Do you want your oldest son to take the two dogs into his home, or maybe your long-time next-door neighbor is the person you want to care for the dogs after you die instead of shipping them across the country to where your son lives? You also need to calculate how much money will be needed to care for your pets, and make sure that you leave that money to the caregiver. You may simply leave the required money as part of your will (though you need to be aware of any delays caused by a prolonged probate process, as we discuss in Chapter 5), or you may set up a trust from which the money can be withdrawn as needed.

TRY TO STAY OUT OF THE ESTATE-PLANNING DOGHOUSE

Leona Helmsley, a 1970s- and 1980s-era New York City real estate tycoon, left $12 million to her dog when she died. Trouble (both the dog's name and what ensued after she died) needed security to be hired by the estate trustees because there were so many death threats against the poor dog. So, take a valuable lesson from this short tale: Whatever you decide to leave to your four-legged family members, don't advertise it!

But beyond the basic care instructions and the financial provisions, you also need to write down any additional requirements or restrictions, some of which may seem silly to your relatives and friends who don't have pets or perhaps only have a single dog or cat. For example:

- **You may want "special friends" to stay together rather than be split up.** If you have several dogs or cats or horses or other animals, you likely have noticed how often two (or sometimes three or more) pets form special bonds with each other (two cats who always nap together and walk side-by-side everywhere they go, or two dogs who play together constantly). Too often, people make somewhat haphazard provisions for their animals' care after they die, resulting in two animals who spend all their time with each other being split up — one cat or dog to one home, and their best friend to another place. Sadly, the result is that one or both often become very depressed, now having lost their owner *and* their best animal friend. And depressed animals often suffer the same effects as depressed people, such as being more susceptible to physical ailments.
- **Specify what should happen to your pets when *they* die.** You may want them to be buried in your backyard (subject to local ordinances), in a pet cemetery, or on your farm or ranch. Or you may want them to be cremated and their ashes dispersed at some particular location, such as where they spent the last years of their lives or on a nearby mountaintop. Whatever your intentions, make sure that the person or people who assume responsibility for your special friends are aware of what you want for your pets' final resting places.

REMEMBER

Don't forget to plan for estate-related taxes on any pets who, from an estate-planning perspective, can be like investment property (a valuable racing or event horse, for example).

TIP

In recent years, many animal welfare organizations have established programs (appropriately sometimes called Guardian Angel Programs) whereby you leave a specified sum of money to the organization (and not necessarily a large sum). In exchange, when you die, they agree to provide foster care for your animals until they place them in their new forever home. Often, you can make specific requests like keeping your pets together because of the bond they've formed. This is a valuable service for people who may not have other options to provide for their animals after they die, and it provides valuable piece of mind, knowing that your pets will be taken care of as you wish. Check with your local animal welfare organization to find out more about these programs.

The estate-planning tenet of "protection" is for all loved ones, including pets.

7

The Part of Tens

IN THIS PART . . .

Ask critical questions to get going on your estate plan.

Avoid “oops” situations in your will.

Navigate tricky estate-planning situations.

IN THIS CHAPTER

» Getting comfortable with estate planning

» Thinking about everyone who's involved

» Setting your mind to doing the plan

Chapter 20

Ten Questions to Get You Rolling on Your Estate Plan

Your estate-planning efforts can be relatively easy or very complex, rather inexpensive or quite costly. No matter the cost or difficulty, your estate plan must reflect your situation. And who knows more about your situation than you do?

Talking to yourself isn't a worrisome sign when it comes to estate planning. Ask yourself the questions in this chapter, and then answer them to find out how to get started on your estate plan!

Why Do I Even Need an Estate Plan?

Sometimes, we all need a little bit of motivation to get going on things that aren't exactly fun or exciting. Estate planning is no exception.

"What the heck, I don't want to take any responsibility for what happens to all my property. I'll just let someone else decide. And I think I'll turn over as much of my property as possible to the government while I'm at it."

Can you see yourself uttering the preceding sentences? Of course not! But if you don't actively plan for what may happen to your estate — not only after you die, but also when you're alive — then you're essentially giving up any hope for control over what happens to your property. Furthermore, your estate will likely suffer a larger tax bite than otherwise necessary.

So, if you need to psych yourself up for what lies ahead in your estate-planning efforts, ask yourself this seemingly rhetorical question and think about how you respond. As we emphasize throughout this book, your two main estate-planning objectives are protection and control, and you need to answer your own question in that context!

If I Need an Estate Plan, Why Doesn't Everyone Have One?

Remember the standard childhood admonition from a parent to a child: "Well, if Johnny jumped off a bridge, would you do the same thing?"

Just because others haven't done their estate planning doesn't mean their shortcomings have to be your downfall. After all, we're talking about *your* hard-earned estate, not theirs!

And if your close family members or friends have been negligent with their estate planning, let them learn from your example after you get your own estate plan in order.

What Are My Top Three Estate-Planning Goals?

Estate planning is very much a matter of give and take, checks and balances, yin and yang — you get the idea. You need to look at all sides and come up with the optimal solution.

So, because of the give and take that occurs in your estate planning — particularly if your estate situation is rather complex — you need to identify your top three goals for you and your estate-planning team's consideration. Are you trying to assure that all your children receive roughly the same amount of your property after you die? Are you trying to minimize the overall tax bite on your sizable estate? Are you trying to protect as much of your estate if you need to tap into government-funded health care or if you need to move to an expensive nursing home? Do you want to leave a lasting legacy that benefits one or more charities? Are you trying to make sure that someone in your family doesn't get anything from your estate?

Make a list of ten estate-planning objectives, and then check off the ones that you see as your top three and concentrate your efforts on them.

Who Do I Want to Take Care Of?

In the broadest sense, you can use your will, trusts, will substitutes, and other estate-planning tools to take care of everyone you're even remotely related to, including your 19th cousin twice removed who lives in Latvia (and whom you've never met in person). As a practical matter, however, you probably want to concentrate your efforts on your closest relatives: your children, grandchildren, siblings, and (if they're still alive) parents and grandparents.

However, you still need to make some key decisions about your closest relatives regarding your estate plan. For example, you may want to simply leave your entire estate to your children, who in turn will someday leave that property (or, more accurately, whatever is left) to their own children. Conversely, if your children are particularly well off, you may want to leave the majority of your estate directly to your grandchildren (perhaps in a trust). Or you may have a favorite cousin who has always been like a sister to you, and you want to help her out, perhaps even ahead of your own children and grandchildren.

Hey, it's your estate and your family, so you make the decisions! But before you start worrying about what to put in your will and what trusts to set up, make sure you identify who in your family is at the top of the line.

What's the Best Way to Protect My Children?

You have many considerations for your children regarding your estate plan. What happens when you die? Is your spouse still alive? Are you still married to your children's other parent, or are you divorced? Are your own parents still alive and well enough to raise grandchildren, if the need arises? And how much money does your children's guardian need to raise your children if you aren't around?

The answers to these questions will help guide what you do in your estate plan for insurance, guardianship, trusts, and other important considerations. So, make sure you think about the big picture when it comes to protecting your children — not just financially, but overall.

How Much Help Do I Need?

In Chapter 1, we introduce your estate-planning team members and note that, depending on your particular needs, you may rely on some (for example, your accountant and attorney) more than others (such as your financial adviser and insurance agent). Someone else — your brother, for example — may require a different "weighting" of assistance because of his own professional background or different personal and family circumstances.

WARNING

Make sure you ask yourself how comfortable you are with estate planning and what you feel comfortable doing yourself. If you decide to build your estate plan from do-it-yourself kits and online templates, such as for wills and certain simplistic trusts, make sure that you're extra careful and you don't build key parts of your plan from incorrect assumptions, such as laws that apply to residents of a different state but not where you live. Mistakes and omissions can be very costly!

What's My Estate-Planning Budget?

To put it bluntly, you can spend lots of money on estate-planning help, even if your needs are rather modest. You can meet with your attorney two or three times a year to review your will, for example, or sit down with your accountant every time your portfolio undergoes some minor changes, but why?

Make no mistake about it, you have to spend at least a little money for estate-planning assistance, but before you spend a single penny, you need to have a general idea of what those costs are for at least the foreseeable future. This way, you can maintain better control over the fees and charges you have to pay and resist some of the more shady estate-planning "deals" out there, such as questionable investments.

Does My Attorney Have the Right Experience?

Is your attorney estate savvy? The law is a broad field with many specialty areas — criminal, civil, real estate, and so on. You may have an existing relationship with an attorney, but you definitely need to assess that person's capabilities with respect to estate-planning knowledge.

Ask your attorney questions such as the following:

- Have you worked on estate planning–related documents like wills and trusts for other clients?
- How many clients have you previously worked with or are you currently working with on estate planning?
- How long have you been in practice?
- How familiar are you with the nuts and bolts of federal and state-level estate and inheritance tax laws and all the rest of the estate-planning mashup?
- What percentage of your business involves estate planning?
- What are the trickiest estate-planning problems you've seen for someone with basically the same situation as me?

Based on your attorney's answers, determine if you feel comfortable with them handling the delicate matters of your estate plan.

Who Are My Confidants about These Plans?

Your estate planning involves an element of soul searching because it forces you to think beyond the present and into the future — a future where you're deceased. So, you may want to think about which family members are going to be a part of your estate-planning process.

Perhaps you feel comfortable talking about your estate plan with your siblings, children, parents, and other family members. Or maybe you see your estate plan as a relatively private matter, for you and your spouse only.

Or perhaps you don't want your spouse to know anything about your estate plan because of some rather serious lack-of-trust issues. (We certainly don't mean to be flippant, but these situations happen!)

Whatever your situation, decide how much various people should know, and make sure that you keep everyone up to date with your estate-planning strategy.

How Do I Know I Can Do My Estate Plan?

Quite possibly you're a bit overwhelmed by the topics we cover in this book, and you're leaning toward saying: "What the heck, I don't want to worry about estate planning."

Trust us: Anyone can do a reasonably good job at basic estate planning, especially with a little help from some trusted and experienced professionals. So, ask yourself what your confidence level is when it comes to estate planning. If you're still on the skeptical side, sit down with your accountant or attorney and pick one or two simple areas — such as your will, if you don't have one or haven't updated yours in a while — as a starting point. Before you know it, you'll be reciting Latin estate-planning phrases with the best of them!

IN THIS CHAPTER

- Sidestepping the booby traps
- Taking enough time to get your will right

Chapter 21

Avoiding Ten Common Mistakes and Problems in Your Will

Making sure that you prepare a valid will is a key part of your estate plan. Your will can be very simple or very complicated, depending on factors such as your personal and family situation and your estate's value. But whether simple or complicated, you can still make several mistakes in your will.

Use this chapter as a checklist of what *not* to do when you prepare your will.

Forgetting to Review Your Will Annually

In the business world, the term *living document* is used to describe a document that inevitably changes over time to reflect new or changed circumstances. Although calling your will — a document in which you discuss what happens after you die — a living document may seem like a contradiction, the term actually fits perfectly!

In Chapter 3, we discuss many different reasons that can cause you to update your will, such as getting married, getting divorced, or having a major change in your financial fortunes.

REMEMBER

Unless you review your will at least once a year, you run the very serious risk of having an out-of-date will — possibly a *very* out-of-date will — when you die.

So, pick a date, any date, that you set aside each year to review your will to see if you need to make any updates to the document. You can always make a game out of your annual review, pretending that you're in a movie reading your will out loud in front of your family and then imagining each person's reaction.

Conduct your annual will review, and if you have any questions or doubts about whether you need to do any updates, contact your attorney.

Forgetting to Include a Residuary ("Leftovers") Clause

REMEMBER

Your will's residuary clause (see Chapter 3) can cover the "leftovers" of your estate (if you want to be very explicit in your will about who will get what property), or it can actually be the main clause you use if you just want to treat most or all of your estate as one big pool to be divided up among your main beneficiaries.

But regardless of your strategy, if you forget to include a *residuary clause* to cover property that you don't specifically mention elsewhere in your will, the law — not you — will dictate how any property that you haven't otherwise mentioned will be distributed and to whom. You'll now have died *partially intestate*, meaning that only some of your property will be covered by your valid will.

This point is a no-brainer: Make sure that whoever prepares your will includes a residuary clause to take care of those leftovers. Or if you prepare your own will from a kit or online resources, make sure that whatever template you're using includes a residuary clause.

Forgetting the "Just in Case" Contingencies

Every baseball, football, hockey, or basketball player has a backup — someone to fill in if something happens, such as the player being injured. In the theater, an actor usually has an understudy — someone who can step in if laryngitis sets in one night, or if the actor just needs to take a break.

In your will, you need to make sure you include those backups and understudies, or *contingencies.* Specifically, include *contingent beneficiaries* who will "fill in" if your main beneficiary dies before you do. Additionally, you must also name a contingent personal representative who can serve in that all-important role if the person whom you've designated for some reason can't do the job.

If you forget to include contingencies, all sorts of complications can set in. Because one of the main goals of spending time on your will is to avoid complications, you're better off focusing a bit more effort on those just-in-case contingencies and making sure they're included in your will.

Sticking with Your Personal Rep When You Really Need a Substitute

After you die, your personal representative needs to make sure that your wishes and instructions are carried out for all aspects of your estate.

But just as you need to review your will annually, you must also periodically ask yourself if the person or institution you selected as your personal representative is still the best choice. You may be having second thoughts for several reasons. For example, you may have chosen your sister to be your personal representative five years ago, but now she's estranged from the family or severely disabled from an automobile accident. Or you may have selected a small-town bank as your personal representative because you've done business with them for more than 30 years, but last year a behemoth, out-of-state financial institution purchased the bank and the people at the local branch have all been laid off.

Even though your instincts may be to avoid making any changes in your estate plan after you have your will and other aspects in place, you need to strongly consider designating a new personal representative if you're now concerned for any reason about your original choice.

Forgetting about All Those Pesky Statutes That Affect Wills

Remember that the laws of the state in which you live play an important role in what happens to your estate. As we discuss in Chapter 4, you can "override" some of those *statutes* in your will, while other statutes are "carved in stone." (So, that would make them sort of "statue statutes, right?")

As you're deciding what you want to write in your will, keep in mind the statutes that you need to deal with. For example, remember that *abatement statutes* come into play when your estate is not valuable enough to meet all your obligations (such as money you still owe), as well as what you've specified in your will about what your beneficiaries are supposed to get.

TIP

Work with your attorney on a number of "what if" scenarios. (For example, what if the value of your stock portfolio falls dramatically? How will that affect what you want to do in your will?) When you do your annual will review, be sure to make any necessary changes to keep unfavorable statutes from coming into play.

Getting Too Precise in Your Will

If you state specific dollar amounts in your will, you risk having your estate being distributed in a way that you really didn't intend. Instead, use percentages wherever possible, particularly for the larger shares of your estate among your beneficiaries.

For example, suppose your estate is valued at $500,000 when you create your will, and you decide to leave most of it to your only daughter, except for $50,000 that you want to go to your only brother. Your intention is that your daughter will get 90 percent of your estate. But when you draft your will, you don't state the particular percentage in your will; instead, you state that $50,000 will go to your brother. (You figure that if the value of your estate rises, your daughter will get even more, but you want to keep your brother's amount fixed at $50,000.)

Suppose that before you die the value of your estate decreases dramatically for some reason, such as a costly medical expense that uses up most of your estate. Or maybe you invested all your money in the latest cryptocurrency, but that particular crypto ended up crashing. When you die, your *total* estate is now worth $75,000. By preparing your will as described earlier, your brother will still get $50,000, but now your daughter will only get $25,000!

If, however, you had specified in your will that your daughter will receive 90 percent and your brother will receive 10 percent, then even though both will receive far less than they would have if your estate were still worth $500,000, at least your intentions of leaving most of your estate to your daughter will still be in effect.

Using Your Beneficiaries as Will Witnesses

WARNING

Never use a beneficiary as a witness to your will. Doing so is a legal conflict of interest and could result in your beneficiary not receiving what you've stated in your will.

The same person as both a beneficiary and a will witness casts a shadow of doubt about what influence that person may have had on you, and it could open the door for other beneficiaries to claim that you were influenced by that "unscrupulous" person.

TIP

If you use an attorney, have their office staff members serve as witnesses. If you don't use an attorney, make sure that your witnesses are not named as beneficiaries in your will.

Failing to Factor in the Personal Side

The decisions you make about your estate that are specified in your will should include your nonmonetary (personal) objectives in addition to your monetary (financial) goals. Don't just go "by the numbers;" instead, really think through the choices you make and consider family, emotional, and other considerations.

For example, suppose you have three children. Two of them are very well off financially, and the third is a struggling would-be social worker. Family tradition may dictate that you split your estate equally among your three children, but you may want to reconsider this tradition and leave more to your not-so-well-off child and less to the others. The choice is yours.

Keeping Important Information from Your Attorney

Make sure to tell your attorney everything you can think of — even personal, sometimes painful, or embarrassing items — when you're deciding what to put in your will. Even if you don't think some long-ago item is relevant, err on the side of too much information.

For example, if long ago as a teenager you were an unmarried parent, make sure that your attorney is aware of this fact, as well as what happened to the child. Are you legally the child's parent? Did you place the child up for adoption? Answers to similar questions will help your attorney put the correct legal language in your will to reflect what you want — or don't want — to happen with your estate with regard to that child.

Tell your attorney if your business is having difficulties or if you and your spouse are having marital problems and divorce looks like a possibility. Your will must be one step ahead of life changes that you may be able to anticipate.

TECHNICAL STUFF

Any attorney you use — including someone for estate planning — is legally required to uphold total secrecy about *anything* you say or that they learn about you. Every state has rules of ethics regarding client confidentiality. So, you can rest assured that your secrets won't wind up being circulated as cocktail party gossip or posted on social media — at least by your attorney. So, spill the beans!

Rushing through Your Will

Take your time! Even if you think you have a relatively uncomplicated family and financial situation and preparing your will can be a snap, you must still go through a number of what-if scenarios to make sure you've thought of everything. Even when working with your attorney, prompt them with the same what-if questions to see if the questions spark any thoughts about potential problems you need to address.

The last thing you want to happen is that you think you have a valid will that accurately reflects what you want to happen with your estate, and then after you die, all kinds of problems surface because you failed to address what you thought were nitpicky details that turned out to be very important.

IN THIS CHAPTER

» Avoiding the wrong person playing a critical role in your estate

» Making your estate plan work even with the most complex family tree

» Keeping your estate wishes properly balanced as the years pass

Chapter 22

Ten Crucial Estate-Planning Questions

Estate planning in general is an extremely complex effort, with many moving parts. You need to think long and hard about these different aspects as you create your estate plan.

Here are ten questions that you should ask — and answer — as you develop your estate plan.

TIP

Even if you encounter some especially challenging estate-related situation that isn't included in this chapter, no worries: The members of your estate-planning team (your attorney, your accountant, your financial adviser) almost certainly have. Get help from the experts when you need to!

How Do I Choose the Right Person to Be the Executor of My Estate?

You spend so much time carefully crafting your estate plan. But the implementation of your estate plan can fall apart if you don't choose the right person for the right task. You have to assess the skill set of the person you're asking to perform each specific estate-planning task in an unbiased fashion, no matter what your personal relationship is with that person.

The person you appoint to be your executor or personal representative needs to be trustworthy, organized, and dependable. They have a fiduciary responsibility to do many tasks, including paying all debts and taxes, securing and appraising assets, and making sure all your beneficiaries receive their designated part of your estate. These characteristics may (or may not) be present in the person(s) you're considering appointing to that role.

Part of the estate-planning process is to "underwrite" (or vet) people to honestly assess what they can do and, just as important, what they can't do. If no one in your personal "circle of trust" meets this litmus test, consider appointing a bank, an attorney, or a certified public accountant (CPA) to perform this function.

How Do I Not Offend Loved Ones with My Estate Planning?

Unfortunately, the simple answer to this question is: You most likely *will* offend someone. For example, maybe you didn't ask them to be your executor or maybe you didn't leave them what they were expecting.

But here's the thing: This estate plan is *yours* and no one else's! Your estate plan is the carefully crafted documentation that specifies all *your* wishes for after you die. You can't worry what others think, or in this case what they *may* think. Your loved ones may not have the same perspective on what you want — the importance of leaving a chunk of your estate to a charity that means a lot to you or to that neighbor who has been such a big help to you as you've aged. You, and only you, get to decide what to do with your estate.

And besides, you won't be around anymore, so they won't be able to complain to you anyway!

How Do I Deal with Family Members Not Following My Estate Plan?

You've done all your estate work and carefully created your estate plan to reflect your wishes for your beneficiaries. But what happens if your loved ones basically say, "Nope, I thought I was getting the car and the antiques, so they're mine" or

"I got to our parents' house first before my out-of-town siblings, so I'm going to take what I want and they can fight over the rest"? How do you handle this gigantic problem, especially when you're no longer alive to intervene?

Aha! These types of situations highlight the importance of choosing a personal representative or executor whom you know will do *exactly* what your estate plan specifies for distributing your assets. If you choose a relative for your personal representative, you need to have a conversation with them *well before* you die to make sure they fully understand your estate plan and how you want everything to be handled. It doesn't matter if your sister "thought" she was your IRA beneficiary; it only matters whom *you* named as the beneficiary. Your estate's personal representative's job is to make sure your wishes are followed to the letter.

How Do I Account for Asset Value Changes in My Estate Plan?

You've taken stock of your assets and created your estate plan. But the assets within your estate will almost certainly change over time — hopefully increasing, but perhaps decreasing in value. The Great Recession of 2008 slammed not only the equity markets but also the housing market. These two asset categories may account for a large proportion of your estate. Even though both stocks and housing eventually recovered and went zooming higher than ever before, what might have happened to the estate of someone who died in, say, 2009 while stock and housing prices were still in the dumps, and the values were way, way off from what had been specified in that person's estate plan?

How do you keep up with the changing asset values over years — or decades — without constantly changing the amount you leave to your beneficiaries?

TIP

One common method is to distribute your assets in percentages rather than in absolute dollar amounts. For example, suppose you have a million dollars in assets when you created your estate plan, and you leave your cousin $100,000 in cash because you'd like him to receive 10 percent of your estate. Over the years, that hot stock tip worked out and your overall estate balloons to a value of $3 million. Now, your cousin's share of your estate has declined from 10 percent to only 3 percent. If you want to retain your cousin's intended 10 percent target, you can leave your cousin and also the rest of your beneficiaries some percentage of your assets rather than an actual dollar amount. Your will would simply state that your cousin is to receive 10 percent of your estate's assets.

REMEMBER

Conversely, a bequest of $25,000 to your favorite charity may be exactly what you want regardless of the size of your estate. In this case, you would specify a specific dollar amount instead of a percentage. Basically, you can "mix and match" percentages and precise dollar amounts as much — or as little — as necessary to achieve your desired distributions.

Can I Appoint Multiple Executors to Handle My Estate?

Two polar opposite sayings come to mind if you want to appoint multiple executors to handle your estate. On the one hand, the more the merrier; on the other hand, too many cooks in the kitchen! In theory, dividing up the many tasks that your personal representative is responsible for handling — distributing assets to beneficiaries, paying the debts of the estate, submitting the final tax return, and so on — may seem like a good idea. But appearances can be deceiving!

WARNING

Issues can arise if your multiple executors aren't on the same page on the processes involved in these tasks, and disagreements could easily arise between them. You need to specify a crystal-clear division of estate tasks and make sure they're fully documented in your estate plan.

Literally, this means specifying in clear language who does what. For example, "Executor A is responsible for all financial matters as it relates to disseminating my assets to my beneficiaries, while Executor B is responsible for paying all debts of my estate." Failure to unambiguously specify who does what may result in confusion, infighting, and resentment among your executors.

What if My Sixth Spouse Doesn't Agree with What I Want for My Estate Plan?

According to the Pew Research Center, four out of ten marriages involve one participant who has been married before. If you've had multiple marriages, you've had a fair number of changes in your life over the years, including changes to your estate plan. What if you want to leave assets to a former spouse or stepchildren from a previous marriage? Your current spouse may not be so happy about that.

We aren't marriage therapists, but the reality is that you absolutely must have an open and honest conversation with your current spouse or partner about your intentions. Community property laws in some states protect your spouse with a required asset allocation to them. After that, it's fair game for you to determine who gets what with the remaining portion of your assets — including former spouses, children, former stepchildren, charities, and so on.

Don't be manipulated into changing your estate plan for the sole reason that your current spouse doesn't agree with it. One way to look at these complexities is that you lived a portion of your life before your current spouse arrived on the scene, so it's logical that a portion of your estate will be left to loved ones who represent a part of your life from before your current relationship.

How Do I Choose Which of My Children Will Handle My Estate?

You need to choose the right person for the right estate-planning task. This comes into play with the common issue of choosing which of your children should be appointed as your executor or personal representative.

You have a couple of considerations with this decision:

- Some of your offspring may not be interested in dealing with the "end game" of your estate, so that can narrow your options right off the bat.
- If one of your children lives closer to you and is more involved in your daily life, including helping with your financial affairs as you age, that person might be the obvious choice.
- Maybe one of your children has the skill set needed to perform the necessary tasks — financial acumen, follow-through, and so on.

You need to make this critically important decision when creating your estate plan, instead of waiting until the classic deathbed scene from the movies. Take your time and choose the child who will follow your estate-planning decisions *and* is fully up to the task.

How Do I Prevent Theft from my Estate?

Wouldn't it be great if, after all the time, effort, and thoughtful planning you've put into creating your estate plan, you could actually see things through to the end to make sure all your beneficiaries receive their intended bequests and nobody stole assets from your estate or took furniture or collectibles that you intended for someone else?

Unfortunately, the start of the estate distribution process means exactly the opposite: You're not around anymore to personally prevent theft from your estate. So, how do you protect the distribution of your estate assets after you've gone to the great farm in the sky? What if your executor decides unilaterally to change their own proceeds from your estate to some larger amount — maybe even a *much* larger amount! — because they decide they're entitled to more than you left them?

Here you have yet another example of the importance of putting safety measures within your estate plan to ensure that your wishes are followed. The best safety measure is choosing someone — or perhaps some outside institution — as your personal representative or executor who you trust to follow through with the terms of your estate plan. Choosing a family member who could be swayed by another family member isn't exactly ideal.

If you have any reservations about your personal representative following the estate plan terms, they aren't the right person for the job. This is when it may be beneficial to enlist a financial professional and designate them as the combined quarterback and security guard of your estate plan. Their lack of any emotional ties to any of your beneficiaries, as well as their required professional accountability, can be just the thing you need to prevent theft from your estate.

Why Does My Estate Plan Seem So Different from Other Plans?

If ever a classic saying does *not* apply to estate planning, it's this: "Imitation is the sincerest form of flattery." Your financial life is unique — your earnings, savings, assets, liabilities, and everything else are yours. Therefore, *your* estate plan is unique to *you.* It doesn't matter what your other family members and friends discuss about their respective estate plans.

WARNING

Don't use a friend's or relative's estate plan as a cookie-cutter model for your own! Sure, you can pick up ideas here and there from friends and relatives. But if you decide to cut corners, or take the path of least resistance, or follow another similar cliché, you're doing yourself — and your estate — a gigantic disservice and may be asking for trouble.

For example, when the first generation of dot-com stocks were red hot in the mid-to late 1990s, hot stock tips were a favorite topic discussed at social gatherings. ("My cousin's financial adviser told him that such-and-such company is definitely going to triple in value — you need to get into this stock!") And although many Internet and other types of tech stocks have certainly done well over the years, a whole lot of them crashed and burned in the 2000–2002 time frame, so mindlessly playing financial follow-the-leader wasn't exactly the best strategy.

Fast-forward to the early 2020s, and you could substitute *cryptocurrency* for *first generation of dot-com stocks* and watch history repeat itself.

Now, overlay the previous warning onto all the estate-planning tools and techniques at your disposal. For example, we've seen people proudly discuss how their assets are protected within the confines of their trust. However, a trust may not be what *you* even need, or you may need a different type of trust that would best serve your needs that are different from those of your friends and colleagues. This book covers the standard forms of legal documentation you should have in your estate plan — a will, power of attorney, health-care directives, and possibly trusts. But these are just general legal documents that need to be individually crafted into your own estate-planning documents.

REMEMBER

You don't need to reinvent the wheel when it comes to your estate plan, but at the same time, you don't want to simply replicate what someone else did without carefully determining the applicability — or lack thereof — to your own estate.

How Do I Know How a Charity Will Use My Gift or Bequest?

Charities serve a valuable function in society and are often included as a beneficiary in estate planning. They're typically nonprofit organizations with a mission statement. However, when you decide to gift or bequeath money to a charity within your estate plan, how do you know the specific ways that money is going to be used by the charity?

For example, if you leave a portion of your estate to an animal charity, will that money be directly used for food, veterinary expenses, and housing for animals? Or will the charity take your money and use it for fundraising, or executive salaries, or some other function that may be important to the "big picture" of their mission, but not how you would've preferred your money be spent?

TIP

The best way to be certain your money is used in a way you want is to *specifically state* in the gift or bequest how you want the money to be used by the charity. Many charities have different functions. For example, if you give money to an animal welfare organization, you can state that you want the money used for the general care of animals, but not for fundraising or administrative expenses. Or you can get even more specific: You want the money to be used only for the medical expenses and rehabilitation of injured animals. Or if you want to leave your money to a nonprofit that specializes in environmental issues, maybe you want your money to be targeted to the purchasing of land for preservation purposes.

REMEMBER

Be sure you understand the charity and their functions so you can specifically request how you want your money to be used. There is no such thing as too much directive or information. The more specific you can be with your estate plan, the better the chances that your gift or bequest will be used in the way you want.

Index

Numbers

A

B

C

D

E

H

I

J

K

L

M

N

O

P

Q

R

S

T

U

V

W

Y

Z

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Jordan Simon: Jordan received his bachelor's degree from the University of Arizona, and his MBA from the University of Southern California, where he was the recipient of the Quon Award as one of the outstanding graduates. He also attended Harvard's Executive Program. Jordan has worked in various classes of asset management throughout his career. His volunteer activities include working with animal welfare nonprofits.

Joe Mashinski: Joe received his AB from Princeton University and his JD from the Dickinson School of Law at Pennsylvania State University. Joe is an attorney and consulting professional with varied experience ranging from estate planning, alternative investments, and financial services to ERISA compliance. Joe has worked for several start-up ventures in alternative investments, artificial intelligence, and fintech.

Dedication

To my mother for her unconditional love and support; for raising me with the mantra "Use up, wear out, make do, or do without;" and for recognizing without judgment my early obsession with retirement and estate planning when asking me as a five-year-old what I wanted to do with a birthday check and my reply of "Save it for retirement" did not even phase her.

To my USC Yayas for their unwavering support and intelligence.

To Corbie, Baxton, Jazz, Sonora, Milo, and Prescott for making life so much better and reminding me of the importance of four-legged estate planning.

—Jordan Simon

To my loving and supportive wife, mom, and sister. Without your unconditional love, support, and most importantly, patience, I would not be where I am today.

To my friends, family, and colleagues who continually challenge me to do my best.

To Johnny, my son, best friend, and inspiration!

To Greg, Jordan, Alan, and Brian — your collaboration and support made this experience quite enjoyable.

—Joe Mashinski

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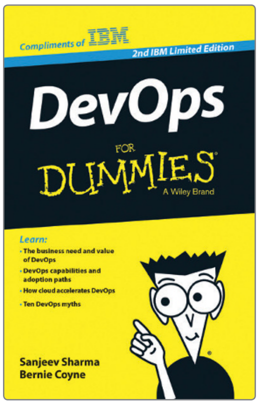

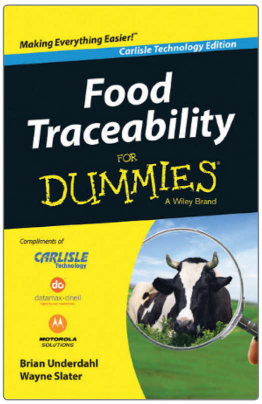

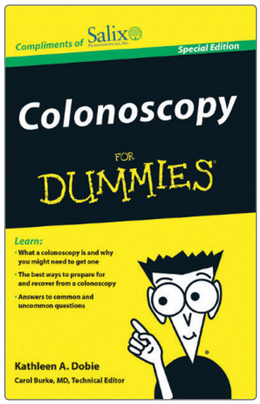

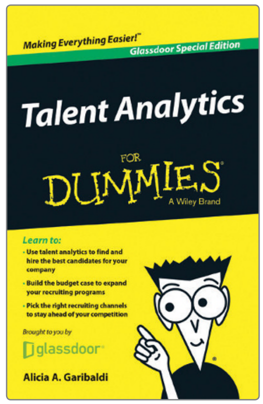

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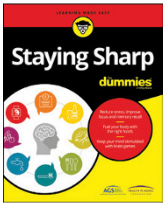

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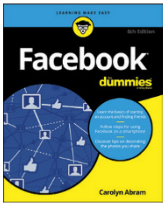

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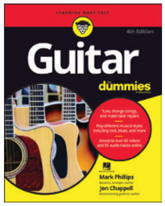

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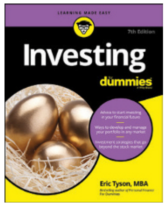

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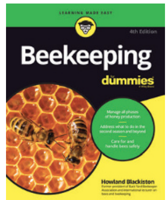

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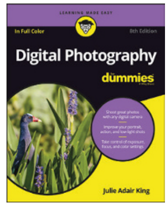

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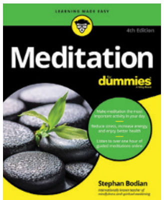

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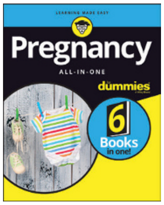

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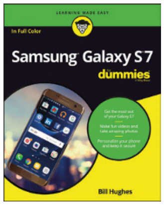

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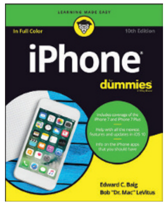

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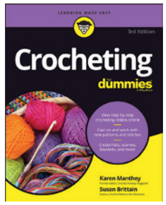

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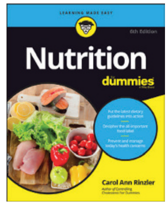

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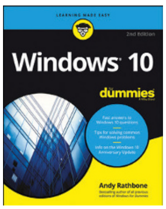

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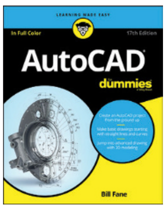

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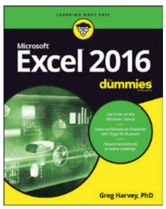

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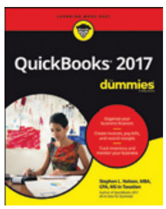

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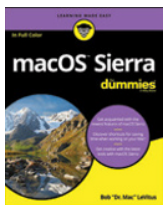

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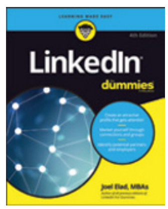

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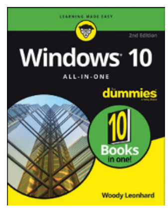

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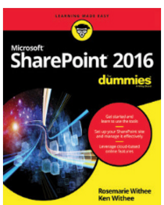

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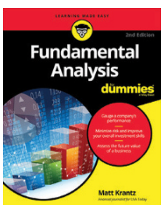

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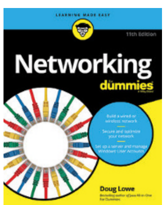

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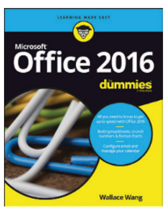

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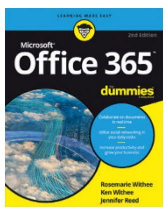

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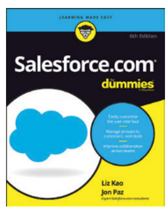

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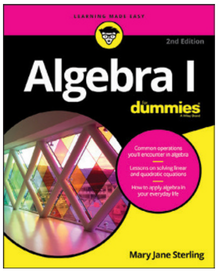

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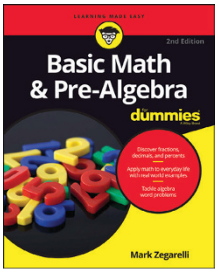

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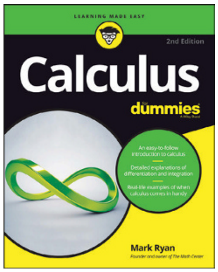

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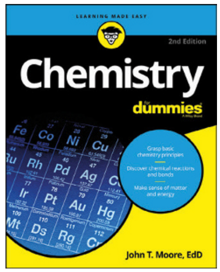

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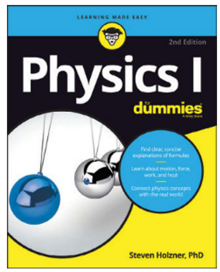

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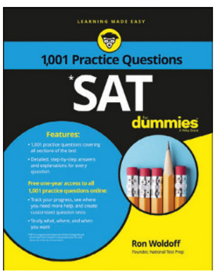

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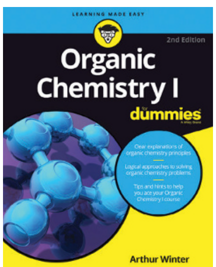

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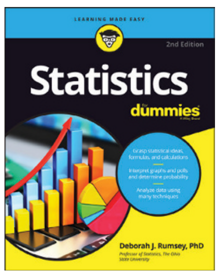

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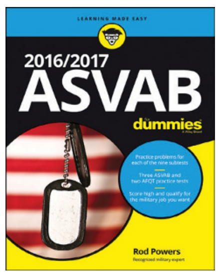

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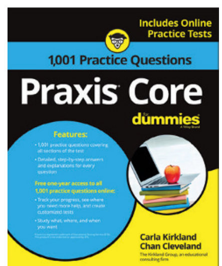

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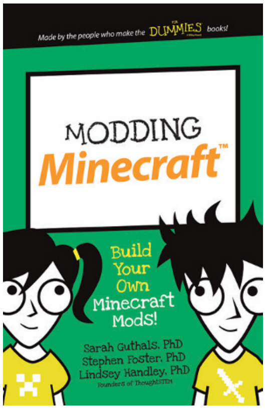

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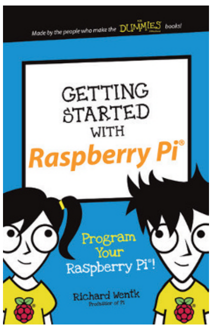

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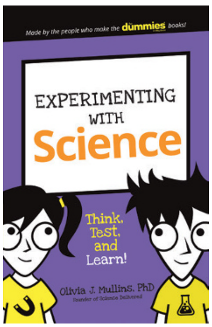

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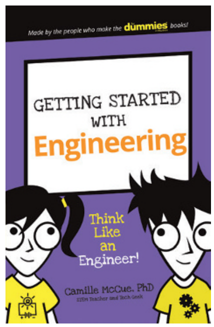

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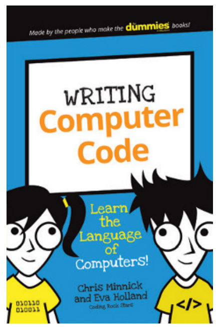

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