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Estate Planning Outline

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This complimentary summary is provided by the firm of Brad Borncamp, CPA, LLC. It explains some of the aspects of estate planning and the laws put in place December 22, 2017 under the Tax Cuts and Jobs Act which apply for 2018 through 2025. This summary is intended to offer general guidance and is not all inclusive, accordingly, it cannot be relied upon as professional advice. Each person's estate is unique and you are strongly encouraged to consult with qualified professional advisors before taking any steps to achieve your estate planning goals.

Why Planning is Important

Planning is vital to achieving financial goals. It involves more than just working hard, filing your annual income tax returns, and saving for retirement. It is essential to get assistance from professional advisors, such as CPA's, attorneys, investment advisors, insurance professionals, and relatives to help design and implement your estate plan. The following are some goals which you should discuss with your advisors:

* Reduce income, estate, and gift taxes
* Choose and use retirement accounts
* Set up tax savings college accounts
* Build net worth and protect assets
* Carry out specific wishes and desires
* Protect family members from creditors
* Provide for an orderly transfer of assets
* Manage cash flows and investment risks

Reasons for Estate Planning

Under the federal tax law passed December 22, 2017 Congress made many changes to the tax laws affecting individuals, businesses, estates, and trusts. This article deals with some of the changes affecting the estate and gift tax laws and offers a simplified explanation of how these laws may affect you and your family.

The impact of the Tax Cuts and Jobs Act on estate and gift taxes is only temporary. It is effective January 1, 2018 through December 31, 2025 (unless they change it sooner) at which time the previous law goes back into effect. The previous law is from 2010 and allowed an estate and gift tax lifetime exclusion of $5,000,000 (before indexing), this would have become $5,600,000 for 2018 (it was $5,490,000 for 2017). It also allowed unlimited step up in basis, and a maximum 40% estate and gift tax rate. The new law doubles the 2018 estate and gift tax exclusion amount to $11,200,000 and will continue to be indexed for inflation. This higher exclusion amount will exempt most estate from tax, but estate planning is still very important even for smaller estates, especially given that the new law is temporary. The following are some of the reasons to do estate planning.

* Name a guardian for your dependents
* Transfer property to specific heirs
* Keep the estate private
* Avoid probate
* Provide security from creditors and predators
* Simplify administration of your estate
* Direct your own medical treatment
* Minimize estate and income taxes

Estate Planning Terminology

To understand estate planning, it really helps to learn the meaning of several key words. For example, did you know that **any person could have several different "estates"**.

* * You may own parcels of ***real*** **estate**
* * If married, you have a ***marital*** **estate**
* * If broke, you may have a ***bankruptcy*** **estate**
* * Upon each person's death, ***two*** **other estates** are created on that day:
  * * a ***probate*** **estate** (for assets titled to the decedent with no named beneficiaries)
  * * a ***taxable*** **estate** (for valuing all assets and calculating estate tax)

Understanding these key words is essential to learning the basics of estate planning. You must know how the word "estate" is being used in any given context or you may misinterpret what is being said and become very confused.

The **probate estate** is limited to the assets you hold title to in your own name which do not have designated beneficiaries. These assets transfer upon death by the terms of your **will** document, or by state statute if you die (intestate) with no will. The probate estate usually does NOT include any assets which have a designated beneficiary (such as accounts with TOD/POD, retirement accounts, life insurance policies, annuities, etc.), assets titled jointly with rights of survivorship (such as a house or bank accounts), or assets you hold in the name of a trust (either revocable or irrevocable) of which you may be a trustee.

The **taxable estate** includes everything you own or have control over, either directly or indirectly and is used as a basis to determine if the estate is required to file Federal and state estate tax returns. This includes all the assets in your probate estate plus any other assets that you control, including those assets with designated beneficiaries, such as TOD/POD accounts, retirement accounts, the death benefit of your life insurance policies, assets in your revocable living trusts, but not irrevocable trust(s). The taxable estate may include many more assets than the probate estate. If estate planning is done correctly, it is very common to have a large taxable estate and have little, if any, of these assets included in your probate estate. This is because the probate estate usually does not include assets that have designated beneficiaries or assets held in the name of a revocable trust, but the taxable estate does include these assets. These rules are complicated so get professional help with this area.

Trusts are often used in estate planning, both to reduce potential estate taxes and to achieve personal goals such as transferring and protecting assets and keeping the estate private. There are basically two types of trusts, those you can change, called "**Revocable**" and those you can NOT change, called "**Irrevocable**". Attorneys often refer to two types of trusts as those formed while the creator (grantor) is alive, called **"intervivos"** trusts and those trusts formed upon the creator's death, called **"testamentary"** trusts. This can be confusing since both revocable and irrevocable trusts can be established while the creator is still alive. It helps to understand that revocable trusts can only be formed or changed while the creator is alive, and that every revocable trust becomes irrevocable upon the death of the creator. Irrevocable trusts can be formed and funded either while the creator is still alive or upon their death. Neither trust can be changed after the creator's death, except for certain actions allowed by the trust document or upon a court order.

Titling assets is an essential part of estate planning. The estate plan can only work if the assets you own are titled correctly. Titling refers to how title to an asset is held. It can be held in the name of one individual (with or without designated beneficiaries), or held jointly with two or more owners either as tenants in common or with rights of survivorship. It can also be help in the name of a trust, in which case the trustee has control over the asset. Titling has a direct effect on the transfer of each estate asset.

Assets can be almost anything. Typically, assets include your house, bank accounts, life insurance policies, investment and retirement accounts, rental and royalty property, an ownership interest in a business, etc. The term asset also includes personal items, such as cars, clothes, collectibles, intangible things such as intellectual property, and the right to use property. It is important to identify and value all assets, net of any debt, and to title each one correctly before death, in order to develop and implement an effective estate plan so that things turn out the way everyone expects.

Personal representative, also known as an estate administrator, is the **person named in your will** to carry out the directions stated in your will document. If there is no will, the probate court will assign a personal representative. This person is also called an executor (if a man) or an executrix (if a woman). This person is responsible for administrating the estate and transferring the probate assets controlled by your will. They also direct the transfer of assets with designated beneficiaries, but they do not deal with assets held in your trust(s) unless they are also named separately as trustee in the trust document.

Trustee may be natural persons or institutions like a bank or trust company and are **named in the trust document** or they can be assigned by the court. They are responsible for carrying out the directions stated in the trust document and transferring the related assets. The trustee does not deal with assets in the probate estate unless they are also named separately as a personal representative in the will or by the court.

Heirs and beneficiaries may be natural persons or they can be trusts and charities. The term heir applies to those receiving an inheritance from an estate. The term beneficiary applies to those receiving distributions from trusts or as designated beneficiaries on estate assets. There can also be contingent beneficiaries (who may not get anything), income beneficiaries (who only get current income), or remainder beneficiaries (who get the assets that are left at some time in the future).

The Basic Estate Planning Strategy

Estate planning strategy takes into account the family's goals and desires while taking advantage of each person's lifetime exclusion. The lifetime exclusion amount for a person dying in 2017 is $5,490,000 and for 2018 is $11,200,000, if not reduced for prior taxable gifts. The federal estate tax rate of 40% applies to the value of the estate, net of any debts, over this exclusion amount. This may be in addition to state level estate tax.

The law continues to allow married couples portability for the lifetime exclusion unused by the first spouse. The unused lifetime exclusion of the first spouse can transfer to the surviving spouse. This increases the amount of the exclusion available upon the surviving spouse's death. It is important to note that a federal estate tax return (Form 706) must be filed within nine months from the date of death of the first spouse in order to elect to apply the unused exclusion to the surviving spouse. Filing Form 706 is required to elect portability even if the estate would not otherwise be required to file a federal estate tax return or pay any tax. In addition, state level estate tax filing requirements may apply based on the decedent's state of residency.

This means that for 2018 through 2025 a married couple with a basic estate plan can exempt the total value of $22,400,000 (2 x $11,200,000) of assets from estate and gift taxes. However, to utilize their combined exclusion, they must either title assets in their separate taxable estates or change their estate plan to include filing an estate tax return upon the first spouse's death to elect portability. Keep in mind the value of the surviving spouse's assets may increase significantly by the time of their death and they may need the additional unused exclusion from the first spouse.

There are generally two planning strategies available to get the benefit of the combined exclusion amounts for both spouses. In either case, spouses (including same sex couples) must be married under state law at the time of the first spouse's death. Larger estates may have more complicated plans to protect assets and achieve the family's goals. Both approaches should be discussed with your professional advisors to develop a plan that considers the value of your current (and future) estate, the potential income taxes, and your personal goals.

A conventional estate plan involves each spouse utilizing their lifetime exclusion to create separate taxable estates by carefully titling assets before the death of either spouse. In this case, each spouse holds assets directly or in a revocable trust, or by titling joint assets as tenants in common, NOT with rights of survivorship. This method allows the assets of the first spouse to die to transfer into an irrevocable family trust which utilizes the some or all of the exclusion amount from the first spouse. The surviving spouse may be the primary beneficiary of the family trust but the assets held in this trust are not part of the surviving spouse's taxable estate. Assets with designated beneficiaries that transfer directly to nonspouse beneficiaries (such as kids) also utilize some of the first spouse's exclusion amount. There may be good reasons to use the conventional approach in order to achieve the family's goals and protect the assets of large estates or to benefit the kids from previous marriages.

A portability estate plan should be considered for estates whose combined total value is expected to never exceed $22,400,000 (2 x $11,200,000 in 2018). The portability approach titles some or all of the assets so they pass directly to the surviving spouse without using trusts. This does not utilize much, if any, of the first spouse's exclusion. This plan anticipates that an estate tax return (form 706) will be timely filed upon the first spouse's death to elect the unused portion of the first spouse's exclusion to transfer to the surviving spouse.

It should be noted that conventional planning techniques using family trusts could result in significant income taxes on the gains related to future sales of the assets held in the family trust if the assets appreciate (increase in value). This is because the assets transferred to the first spouse's family trust get a (stepped up) basis equal to the fair market value at the date of death of the first spouse. The assets held in this family trust retain this basis and do not get a second step up in basis at the time of the surviving spouse's death in the future. Planning should be done to analyze the potential for appreciation of estate assets and determine if conventional planning techniques should be used or if the plan should be revised to transfer assets between spouses (instead of using a family trust) and use portability at the first spouse's death. A portability plan allows all the assets held in the surviving spouse's estate, including those transferred to the surviving spouse from the first spouse's estate, to get a step up in basis upon the second spouse's death. The portability plan may reduce the gains realized from the sales of appreciated assets which are sold by the second spouse's estate, or their heirs. This may result in significantly lower income taxes after the second spouse's death.

The tax law allows a married couple a total combined estate and gift tax exclusion of $22,400,000 (but only through 2025), a 40% maximum federal estate and gift tax rate, and portability of the unused estate exclusion to the surviving spouse. This may give people the impression that estate planning is no longer necessary. However, as this article points out, there may be significant income tax differences as a result of keeping your conventional planning strategy and there are many non-tax reasons to do estate planning. Not to mention, many states have their own version of an estate tax which may differ greatly from the federal laws.

What Information is Needed For Estate Planning

Your estate planning can be simple or complicated, depending on the complexity of your situation and your desires. Significant benefits can usually be gained even if you only do basic estate planning. This process usually involves the following information.

* Draft and/or review your will and trust documents
* Make a list of all your assets, investments, debts, etc.
* Document how each asset is titled and note designated beneficiaries, if any
* Identify who will inherit the assets in your estate and when or at what age
* Identify the person(s) to manage your estate and trust
* Identify the person(s) to be guardian of minor children of disabled dependents
* Describe how to deal with special needs of your heirs or beneficiaries
* Indicate what amounts (if any) go to certain charities
* Document what medical treatments you want to endure
* Note certain funeral arrangements you may want

Steps Involved

There are basically two steps involved in establishing your estate plan, documentation and implementation. Each step involves various activities which may require the services of a CPA, attorney, trustee, insurance agent, investment advisor, and others.

Documentation occurs as you establish your estate planning goals, identify all estate assets, and gain an understanding of how to implement the plan. The related legal documents are drafted with the appropriate language to achieve these goals. Estate planning documentation typically involves the following legal documents.

* Last will and testament (a will) for each spouse
* Revocable Living trust for each spouse
* Durable power of attorney, in case you become incapacitated
* Medical power of attorney, to authorize medical treatments
* Medical directive (living will), to direct the extent of life sustaining procedures

Implementation occurs over time and involves titling assets and monitoring events to see if changes to the documents may become necessary. This starts before the death of the first spouse (if married) by titling assets to assure the proper transfer of each asset to your spouse or other heirs. You should enlist the assistance of an attorney and other estate planning professionals to assist you with understanding how to title your assets and to designate beneficiaries in order to make sure this step is carried out correctly. It is advisable to discuss your estate plan and related documents with family members, especially the people who will administer your estate. As time goes by, it may be necessary to update the plan for changes in your family, your assets, or the tax laws.

Estate Administration

Administration of your estate starts at death and involves, among other things, the documents you created and the transfer of your assets. These documents tell your personal representative and trustee how and when to transfer your assets and who should be the guardian of certain dependents. The personal representative and trustee carry out your directions by following the instructions of your will and trust(s) documents. They usually need to inform any banks, retirement and investment accounts, insurance companies, and others of your death in order to distribute the related accounts. Estate administration usually involves, either directly or indirectly, the following people.

* The personal representative to make funeral arrangements and execute your will.
* The trustee(s) to manage and direct assets held in, or transferred to, your trust(s).
* The attorney to assist with the probate process and any legal issues.
* The CPA to prepare estate and income tax returns and offer tax planning advice.
* The investment advisor to help manage investments and make distributions to heirs.
* The banker, insurance agent, and others who help with transferring assets.

Taxes Involved With An Estate

There are **five separate** types of taxes that may impact your estate: income taxes, gift tax, estate tax, generation skipping tax, and state estate or inheritance tax.

* ***Income taxes*** (federal and state) apply to the net taxable income of trusts and estates starting at much higher tax rates than for individuals. Knowing when a trust or estate should distribute income may significantly reduce income taxes, especially since the 37% top tax rate plus the additional 3.8% Net Investment tax apply to trusts and estates with undistributed taxable income over $12,700 (for 2018). Form 1041 is the federal income tax return filed for trusts and estates.
* ***Gift tax*** applies to the value of property, or rights to such property, transferred while you are alive. Knowing how to use the annual gift allowance and lifetime exclusion amounts and applicable discounts may significantly reduce the gift taxes. Planning for the gifting of appreciated assets may significantly reduce the related income taxes. Form 709 is the federal gift tax return to be filed by the donor.
* ***Estate taxes*** (federal and state) apply to the value of all property in your taxable estate at the time of your death. Planning strategies, such as those discussed in this article, may save significant amounts of both federal and state estate taxes. Form 706 is used to report taxable estates, calculate the federal estate tax, or elect portability.
* ***Generation skipping tax* (GST)** applies to the value of property transferred directly to more than one generation below you and is in addition to the federal estate tax.
* ***State inheritance tax*** applies to the heirs who inherit assets from residents of those states that have an inheritance tax, based on the value of property transferred.

Get Professional Help

In summary, even with the somewhat liberalized estate tax law now in effect, planning is as important as ever, regardless of the size of your estate.

Call to discuss your situation and how we may ***"help you keep more of what you make"***.

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