The Wealth Counselor

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An Overview of Estate Planning

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Planning for Peace of Mind.

Our clients expect their estate planning will cause their property to go to whom they want, the way they want, when they want and that it will minimize the impact of taxes, professional fees and court costs. They also expect their estate planning will help them keep control of their property while they are alive and well and provide for themselves and their loved ones if they become disabled.

Traditional estate planning often falls short of some of these goals. In this issue of *The Wealth Counselor*, we will examine the traditional estate planning process, some of its shortfalls, how modern estate planning overcomes them, and the pros can cons of modern versus traditional estate planning.

The advisor who understands the advantages and disadvantages of various modern and traditional estate planning techniques will be able to influence not just their client, but their client's family for generations to come, bringing considerable value to both their client and to the advisory team.

Traditional Estate Planning

Traditional estate planning is focused on the transfer of ownership of assets at their owner's death. Its cornerstone is the will. Too often traditional estate planners treated the creation of an estate plan as a transaction. They would also often ignore the client's assets that are not usually subject to probate and focus only on the assets that, with traditional estate planning, must go through the probate process before they can pass to the heirs.

It relied on the durable power of attorney to protect the client from having an expensive court ordered and administered guardianship in case of incapacity.

In today's world, with a proliferation of non-probate assets, a more mobile society, and increased longevity, traditional estate planning often falls short of your clients' goals. It does not provide for your client's disability; it does not necessarily give what they have to whom they want, the way they want, and when they want; it will not avoid probate; and it too often ignores or inadequately deals with non-probate assets.

Non-Probate Assets

"Non-probate" assets are those that pass on death in accordance with some contract and thus without being

involved in the probate process. In the traditional estate planning days, pretty much the only non-probate asset one ever saw was life insurance. In modern times, the portion of the typical estate that is non-probate assets has dramatically increased.

Where once defined benefit retirement plans for the worker and the worker's spouse were the norm, today the norm is the defined contribution plan, which passes by beneficiary designation. Today's planners must also deal with right of survivorship property, IRAs, and all sorts of annuities. Moreover, non-probate assets are typically a much larger portion of today's client's total wealth than they were in the days of traditional estate planning.

The proliferation of the types of no-probate assets, especially accounts with transfer on death or right of survivorship provisions, have likely led many of your clients to the false conclusion that they do not need to invest their time and money in estate planning to avoid probate and meet their estate planning goals. Nothing could be further from the truth.

Reliance on the most typical non-probate account provision, joint ownership with right of survival, for example, creates risks for the asset owner that are seldom considered.

Adding a co- or joint owner exposes the affected asset to the co- or joint owner's liabilities, increasing the owner's risk of being named in a lawsuit or losing the asset to a creditor of the co- or joint owner. There is also the risk that the joint or co-owner will not be able to resist the temptation to take or use the property while its original owner is still living.

With some assets, especially real estate, all owners must sign to transact business. If a co-owner (including an owner's spouse) is unable to do so because of incapacity, a guardianship may be required to have someone able to act for the incapacitated owner.

With right of survivorship property, when one owner dies, full ownership usually does transfer to the surviving owner without probate; but what if that owner dies without adding a new joint owner, or if both owners die at the same time? Then the asset must pass through probate before it can go to the heirs. And because a will does not control most jointly owned assets, someone in your client's family could become unintentionally disinherited when the property transfers automatically on death.

Planning Tip: Joint ownership with right of survivorship is often relied upon as a probate-avoidance mechanism, but its risks are often not even considered.

Moreover, avoidance of probate is not guaranteed with non-probate transfers. If "my estate" is listed as the beneficiary, or if a valid beneficiary is not named, the affected non-probate assets will have to go through probate, which will determine who gets what part of the estate. So, too, if a minor is the beneficiary, the asset holder will probably insist on there being a court-appointed and supervised guardian to receive the assets and manage them for the minor.

There is, however, one kind of non-probate asset system that has been demonstrated to work exceedingly well to meet all of the client's estate planning goals. That is the revocable living trust. Property that is held in a client's revocable living trust will bypass probate and can be used by the trustee to care for the incapacitated

owner without court involvement or interference. Other non-probate assets that name the client's revocable living trust as the beneficiary will also bypass probate.

Modern Estate Planning

Modern estate planning is not a transaction; it is a process. It involves not only your client but many generations. It allows your client to care for their loved ones with resources, love and wisdom. It truly is "wealth counseling." Modern estate planning is not just something done to plan for death – it is planning for life, and life involves changes and uncertainties.

Typically the cornerstone of a modern estate plan is a revocable living trust, because a properly funded revocable living trust can avoid both the huge expense of guardianship if the client becomes incapacitated and the expense and delays of probate when the client dies. But a revocable living trust plan is not a Ronco appliance – your client can't just "set it and forget it." Over time your client's assets change, their family members' circumstances change, and the law changes. There is trust in the saying, "There is nothing as certain as change." Failure to fund a revocable living trust and keep it properly maintained is an almost sure fire way to get to a probate court.

The modern estate planning process, therefore, includes education, design, drafting of the documents, and implementation. Like traditional estate planning, modern estate planning includes medical directives. Today those include a health care power of attorney, a living will, and a HIPAA authorization. For asset management if the client becomes incapacitated, modern estate planning uses a revocable living trust, backed up by a durable power of attorney.

Planning Tip: A living will lets their physician know the kind of life support treatment your client would want in case of a terminal illness or injury. But its scope is limited, and in some states physicians are under no legal obligation to follow it. A health care power of attorney is broader; it lets your client give legal authority to another person in advance to make *any* health care decisions for your client—including the use of life support—should your client become unable to make them.

Revocable Living Trust

A living trust-centered estate plan is more likely to achieve your client's goals in today's world. It plans for your client's disability, provides for your client's loved ones, contains your client's caring instructions, addresses your client's fears, and reflects your client's love and values. It can also avoid probate, is valid in every state, and is more private and confidential than a will. For all these reasons, a living trust-centered plan has become the plan most preferred by estate planning professionals and clients alike.

Planning for Disability

Planning for disability with a living trust is superior to relying solely on a durable power of attorney. Today, many financial institutions and other third parties will not accept a durable power of attorney unless it is recently signed and on their own form. But they will, and indeed must accept the instructions of a trustee (or successor trustee) named in a revocable living trust concerning the trust assets. This makes it less likely that a guardianship/conservatorship will be needed for your client. (Note: A will has no effect at disability because it can only go into effect after your client dies.)

Planning Tip: Usually, several successor trustees are named in a trust, in the order in which the grantor wants them to serve. It is a good idea for your client to also have a durable power of attorney with the same successors named, in the same order, for even more ease of acceptance.

Why a Revocable Living Trust Works

The concept is simple. When a revocable living trust is established, the name on the titles to the client's assets is changed to the trustee of the trust. Legally, the individual no longer owns the assets; the trustee of the trust owns them. Thus, when the individual becomes disabled or dies, there is no reason for the court to become involved. The trustee (or successor trustee) already has the legal authority to transact business with the assets. The trust is made revocable so the client retains the power to change his or her mind as well as adapt their plan to changes in their assets, their family, and the law.

Planning Tip: Most people name themselves as trustee of their revocable living trust so they can keep control of their assets, naming a successor to step in when they can no longer conduct business due to incapacity or death. Many include a corporate trustee as co-trustee for professional asset management.

Avoiding Probate

Probate administration is very state specific; procedures and costs vary greatly from state to state. Wills do not avoid probate. Assets titled in the client's name at death and assets that are directed by a will must go through the probate process before they can be distributed to the heirs. If a client dies intestate (without a will), their assets will be distributed according to the probate laws in that state, which will almost certainly *not* be what the client would want. If a client owns out-of-state real property, probate is usually required in each state in which the client owned real property at death.

As explained earlier, many assets (survivorship and pay-on-death property, life insurance, IRAs, defined contribution retirement plans, and annuities) are designed to pass outside of probate. That can result in an uncoordinated estate plan. Moreover, many clients—and even attorneys and professionals—fail to understand the importance of asset titling and beneficiary designations, and it is not unusual for a non-probate asset to *become* a probate asset because of a title or beneficiary designation that is incorrect or out of date.

Living trusts can avoid the need for probate altogether if the titles of all assets have been vested in the trustee and all beneficiary designations have been changed to the trustee of the trust. However, probate avoidance requires rigorous maintenance of titling and beneficiary designations. All it takes to require probate is for your client to open a bank or brokerage account in their individual name instead of as trustee. Also, because living trusts are valid in all states, the need for multiple probates can be eliminated.

Planning Tip: It is important to avoid any asset or beneficiary designation not being changed to the trust. If one is forgotten, or the valid reason for not putting it into the trust to begin with no longer exists, probate may become necessary. If that happens, the client's "pour-over" will, a standard accompanying document to a living trust, will redirect the asset into the client's trust. The asset may have to go through probate first, but it can then be distributed according to the client's instructions in the trust.

Planning Tip: It is usually advisable to transfer a client's home and all their other valuable assets to their trust to make sure they all become part of the unified trust-based estate plan.

Privacy and Confidentiality
Once filed for probate, a will becomes a public document. Moreover, many states have a statutory requirement to file a decedent's will even if there is no probate. With rare exceptions, probate files are open to the public, and private information has become a commodity. Do clients really want the planning they have put in place for their loved ones and what their loved ones will inherit to become public information?

Living trusts are not a matter of public record. While some states now do require some notices, a living trust provides more privacy than any other estate planning mechanism.

How to Distribute Assets to Heirs
Distributions made outright to your client's heirs have no protection from the variety of risks to which personally-held assets are exposed. Once distributed, the heirs can use those assets however they choose and the assets can be subject to their creditors' claims. However, bequests that are kept "in trust" for the benefit of the heirs enjoy protection from creditors, predators (including ex-spouses), irresponsible spending (protection from "self") and future estate taxes. Assets kept in trust can also provide for individuals with special needs without affecting their entitlement to valuable government benefits.

Basic Estate and Gift Tax Rules
Proper estate planning should always consider estate and gift tax rules. The estate and gift taxes are transfer taxe They apply to everything your client owns unless their transfer fall under a tax exclusion. Here are the rules for federal transfer taxes that, unless changed, will be in effect until the end of 2012:

* Estate transfers and gifts are taxed at a flat 35%.
* There is a $13,000 annual exclusion for present interest gifts to each individual. (Amount is indexed for inflation.)
* There is an unlimited marital deduction applicable to gifts to a U.S. citizen spouse.
* There is a $5,120,000 unified exclusion for gifts and death transfers not covered by annual exclusions or a marital or charitable deduction. Under current legislation, it becomes $1 million in 2013.
* There is an unlimited charitable deduction.

Of course, any exemptions that are not used in planning are lost when the client dies or tax laws change. Speaking of change, there is a major change scheduled for December 31, 2012.

Under current law, on January 1, 2013, the maximum transfer rate will increase from 35% to 55% and the unified exclusion will be reduced from $5,120,000 to $1,000,000.

What can we expect between now and 2013? This is definitely a political issue, and one that the House Democrats have targeted. Possibilities bandied about include a $5 million unified exclusion and 35% tax rate; $3.5 million unified exclusion and 45% tax rate; permanent repeal; the end of the unified exclusion; and a $1 million exclusion with graduated rates up to 55%.

Planning Tip: Some states have their own death/inheritance tax in addition to the federal transfer taxes. Often they begin at a much lower level than the current unified exclusions. So, while a client could be exempt from federal taxes, their estate may have to pay state transfer taxes. Make sure you know your state's laws.

Conclusion

Many clients put off estate planning, thinking they have plenty of time to do it before they die. But the truth is that none of us knows how long we have. We only have to watch the nightly news to be reminded of that. And, estate planning should be a process, not a transaction. The advisor who understands this, as well as the advantages and disadvantages of the various estate planning mechanisms, will be able to provide an invaluable service to their clients and their families.