

# Reassessing Your Risk Tolerance? Don't Overlook Estate Planning

Many people do not see an estate plan as necessary. Others recognize the need to plan, but have no idea whom to contact or how to begin.

Estate planning encompasses much more than simply protecting one's assets; it provides peace of mind that your assets will pass according to your wishes at the least cost and administrative burden. Whatever one's reasons for taking the risk of not planning, there is no doubt that it is a risk that one should not take.

## Why Have an Estate Plan?

By neglecting to have even the most basic estate planning document—a will—you leave your estate planning to your state government, with possible adverse results. A local court may have to appoint an administrator to manage your estate. This person, possibly a stranger to you, must be paid. Even if the administrator named is your surviving spouse, a bond is generally required. The amount of time required to settle your estate may be unnecessarily long. Additionally, part of your estate may pass to the federal and state governments in the form of avoidable taxes. Finally, if you have children, then the court will have to appoint a guardian to care for them after you die, which will add emotional and financial burdens for the legal proceedings. Clearly, one imperative of estate planning is: Don't die without a will.

While most people understand that a will is necessary to transfer assets at their death, they may not know its limitations. Property can actually be transferred several ways:

- By a properly executed will or trust,
- By contract, or
- By operation of law.

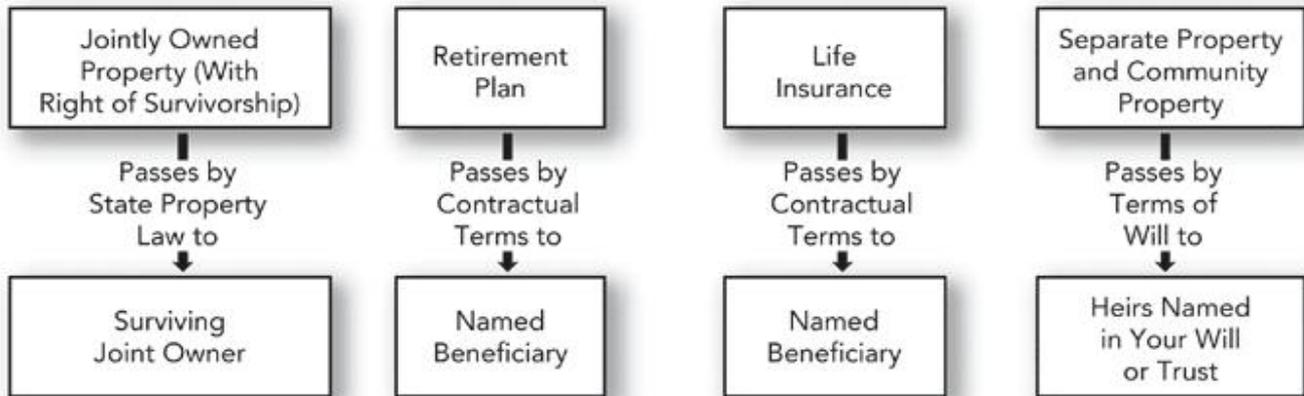
Table 1 provides some examples of how different assets are transferred at death.

### ***Transfer by Will***

As a general rule, a will provides for the transfer of property owned by an individual, including his or her interest in community property titled in the name of the other spouse. Specific bequests of tangible personal property (e.g., jewelry, furniture), may also be addressed in the will or in a separate memorandum referenced in the will, if permitted by state law. However, a will does not

dispose of assets governed by contract or operation of law.

**Table 1**



### ***Transfer by Contract***

Examples of assets that are governed by contract include annuities, IRAs, employee benefit programs or life insurance. A properly executed beneficiary designation form is necessary to ensure that these assets will pass to the intended persons. Regardless of what your will says, these assets will go to the person listed as the contract beneficiary. Additionally, your beneficiary designation may have both estate and income tax ramifications, particularly for IRAs or employee benefit programs. Therefore, it is important that the designations agree with your overall estate and financial plan.

### ***Transfer by State Law***

State law also may affect the disposition of your assets. Assets that pass by operation of law include anything that can be held in joint title, such as a bank account or a house. If you hold a house jointly with right of survivorship, then the house will automatically pass to the other person on the title at your death, regardless of what is stated in your will. In some states, you may be prohibited from disinheriting a spouse or other close relative. Additionally, if you reside in a state that follows the community property system of asset ownership, then state law will supersede the terms of your will in disposing of assets held with a spouse.

## Other Estate Documents

Additionally, an estate plan includes more than disposition of your assets at death. It should also include the possible need to administer your assets or make health care decisions if you are temporarily incapacitated. Most financial planners recommend having sufficient savings to fund up to six months of your living expenses, but who would pay your bills if you are unable to do so? If you do not give someone explicit authority to do so, then even a spouse may need to seek court permission to act on your behalf. This again would cause unnecessary emotional and financial burdens at an already stressful time.

For these reasons, in addition to a will, you should consider establishing two types of powers of attorney:

1. A durable general power of attorney to delegate the ability to make and implement financial decisions, and
2. A health care power of attorney to delegate the ability to make and implement health care decisions. The powers that can be delegated in these documents and the form of the documents differ greatly by state. A living will (sometimes called an advance directive) should also be considered to describe the type and extent of life-sustaining medical treatment that you prefer in the event that you are unable to communicate those wishes.

## What Is the Estate Tax?

Estate taxes do not apply only to the very wealthy. A surprising number of modest estates may be subject to estate taxes without proper planning. An individual with a house, a retirement plan and life insurance may likely have assets that exceed the amount that is exempted from estate tax. For 2011 and 2012 that amount is \$5 million, the threshold at which you should think about doing estate planning. Therefore, it is important to understand not only federal estate and gift taxes, but also possible state estate, gift and inheritance taxes.

The estate tax is really a transfer tax, because it applies to property transfers during lifetime (such as gifts) and at death (such as inheritances). Transfer taxes are progressive, which means that all lifetime taxable gifts are cumulative, so that over time you are subjected to higher tax brackets. Therefore, as the value of your estate increases, planning becomes more important.

The marginal gift and estate tax rates currently range from 15% to 35%. Certain credits and deductions are available to offset the tax. For example, every individual taxpayer can transfer a certain amount of property either during life or at death without paying estate or gift tax, due to a

lifetime exemption amount. The lifetime gift exemption amount is currently \$5 million. Additionally, transfers to grandchildren and certain other individuals are subject to another tax called the generation-skipping transfer (GST) tax that is imposed at the highest estate tax level.

For more information on the estate tax, gift tax and generation-skipping tax, go to the IRS website at [www.irs.gov](http://www.irs.gov). Details can be found in Publication 950, Introduction to Estate and Gift Taxes; and Form 706 Instructions to the U.S. Estate Tax Return and Form 709 Instructions to the U.S. Gift Tax Return.

## How Do I Start Planning?

Estate planning does not need to be seen as a complex set of questions. Instead, it can be a relatively easy process of six steps:

1. Identify the goals,
2. Gather the data and make assumptions,
3. Evaluate the feasibility of your goals,
4. Develop your strategies,
5. Implement the decisions, and
6. Review your progress.

In the estate planning process, these steps can be summarized as follows:

### ***Identify the Goals***

The starting point of a successful estate plan, as with any area of financial planning, is identifying and defining your goals. Here are some questions you should answer that will help you identify your goals:

- What is the most appropriate way to dispose of your assets at your death?
- Who will receive what, and when will they receive it?
- Will assistance in the management of the assets be required?
- If you have minor children, who will care for them the way you would, and with what financial resources?
- How can the costs of administering your estate, including taxes, be minimized?
- Have you appointed an agent to act on your behalf in the event of your disability?
- Will your family be adequately provided for in the event of your premature death?

## ***Gather the Data and Make Assumptions***

After you have identified your goals, you can begin to gather data. You will need to collect your current estate planning documents, including wills and trust instruments, beneficiary designations on retirement plans and insurance policies and title documents that set out the ownership of major assets such as your home. In addition, you need to quantify the value of your assets and your liabilities. You must also consider non-financial issues, such as asset management and protection and the timing of when you want your assets to ultimately pass to your heirs.

## ***Evaluate the Feasibility of Your Goals***

Most goals dealing with the disposition of assets can be accomplished with estate planning. However, you cannot completely control how your heirs spend their inheritance. Similarly, in large estates, some amount of estate taxes may be incurred, even with planning. It may not be possible to meet goals of complete control or elimination of taxes.

## ***Develop Your Strategies***

Identify the planning documents that must be drafted or revised. Determine which tax planning strategies may be appropriate. Consider the individuals or entities to which you want to entrust your assets after your death. Assess the needs of your family members—including your spouse, parents, children and grandchildren—in light of your death. Consider the financial security of your survivors and the adequacy of your life insurance coverage.

## ***Implement the Decisions***

Your decision is meaningless until you turn your words into deeds. In this step, you implement the strategies you developed and execute legal documents. Assign specific tasks to yourself and other family members and determine whether professional assistance is needed.

## ***Review Your Progress***

This final step is easy to ignore, but it is among the most critical. Few decisions are static; we base our choices on a series of events and circumstances that can and do change. Every few years or after a major life event—a marriage, adoption or birth of a child, death of a child or spouse, disability, serious illness, inheritance, divorce, retirement or career change—you should reconsider the various

aspects of your plan. Have your goals changed? Has the law changed? Have new or better options become available?

## Conclusion

Once you have recognized the risks of not having an estate plan, and how relatively simple it can be to establish one, then perhaps you will be motivated to go through the process outlined above. At a minimum, a will and powers of attorney, coordinated with the proper titling of assets and beneficiary designations, can help you to administer your assets during life and at death.

If you may be subject to gift, estate or GST tax, then you may want to implement more sophisticated estate planning techniques, which would probably require consultation with a professional.

There is no doubt that estate planning can force some difficult decisions. However, if you ignore these issues, then you are risking not only unnecessary taxes, but also unnecessary administrative burdens or anguish for those you leave behind.