Estate Planning for the 21st Century




Inside This Guide Book

Alice Lloyd College
Providing Leadership for Appalachia

WHY PLAN YOUR ESTATE?

The fabric of people's lives is woven from the choices they make. Where to live? Whom to marry? What career to follow? Yet all too often we are governed by the choices we fail to make – the non-decisions that can come about from procrastination, ignorance or apathy. Estate planning is a good example. People can choose to plan their estates. Or they can do nothing . . . and thereby make many unconscious choices that their heirs will have to live with:

- The choice to let state law decide how their property will be divided at death;
- The choice to let a court name the persons who will administer their estates or act as guardians for minor children;
- The choice to have their estates unduly depleted by death taxes and costs of administration;
- The choice to let their deaths bring about chaos for their businesses;
- The choice to leave nothing at death to the worthwhile institutions and causes they supported in life.

Not many people would consciously make any of the above "choices". . . yet the failure to plan adequately can amount to the same thing. People who plan their estates aren't guaranteed of making the right choices. But they are assured that they and their advisers will be the ones doing the choosing.

We hope this booklet proves helpful in pointing out some estate planning ideas that you can discuss with your advisers. We also think that you will find that a planned gift or bequest for our benefit can help you accomplish your estate planning purposes. And we promise you that we will do everything we can to make any gift, bequest or trust for our future as financially sound and personally satisfying as is humanly possible. We invite you to call us at any time about all your charitable objectives and plans.

THE IMPORTANCE OF A WILL

For most people, estate planning begins (and sometimes ends) with a will. Your will – thoughtfully planned, skillfully executed and carefully kept up-to-date – may be the most realistic way to ensure after your death the accomplishment of your personal and family objectives.[1] In a well-planned will, executed with the vitally important assistance of your attorney,[2] you can direct precisely how you wish


your estate to be distributed after your lifetime. And you often can maximize the amount of property that will actually pass to your beneficiaries – by minimizing the amount that could be needlessly lost in “death taxes.”

In your will you may nominate those friends or relatives whom you would like to become the guardians of your minor children in the event they become orphans. A court generally will designate the persons you name. But if no will exists to express your wishes, the court will name the guardian of its own choice and may establish rigid, cumbersome and costly guardianship arrangements.

A will often can prevent an injustice to a survivor. Consider, for example, a widowed mother of two children – a healthy adult son with a good job and a minor daughter with disabilities who requires constant nursing care. The mother dies without a will. The law in her state requires that her modest estate be divided equally between her son and daughter.[3] A court-appointed administrator must obey the law; he or she cannot undo the injustice that could have been prevented by a will.

A will also lets you continue your support for the worthwhile causes and institutions that matter in your life. Remember, without a will, living trust or other special arrangement, nothing from your estate will go to benefit our future.

Why have a will? A better question would be: “Shouldn’t everyone have a will?” The sad fact, however, is that most people never get around to making a will (estimates are that from 50% to 85% of all Americans die “intestate”). Sadder yet is the fact that will-making is basically an easy and inexpensive task.

A STEP-BY-STEP PLAN FOR A SUCCESSFUL WILL

Getting your will “off the ground” is easy: Simply call an attorney – today, before you put it off any longer. Tell him or her you want to make an appointment to plan your will. If you don’t know of an attorney to call, ask a friend or relative to recommend one. Your local bar association may have a lawyer referral service that can help you.

Take time before the initial meeting with your attorney to reflect upon the goals and objectives you want to attain through your will. Be prepared to point out to your attorney special family needs that should be taken into account in your will.

Finally, follow through with your will-making plans. Keep the initial appointment and all future appointments with your attorney. Remember, too, that your completed will should be reviewed periodically to make sure that it remains current with changing needs and events.

PLANNING A BEQUEST TO BENEFIT OUR FUTURE

If a bequest for our benefit makes sense in your will plans, you should plan that bequest for maximum personal satisfaction. Many good planning techniques are available. For example, your bequest can be of a stated dollar amount. Or you can bequeath specific property to us. Some of our friends prefer to bequeath a certain percentage of their residuary estate (the amount that remains after paying all debts, costs and other prior legacies). Remember, too, that you can earmark your bequest for special purposes, or you can simply direct that your bequest be used for our current needs. Your bequest can be immediate . . . or in trust . . . or contingent. Whatever your objectives, we will be happy to work with you in planning a bequest that will be satisfying, economical and effective.

Note: We will be pleased to supply your attorney with suggested wording for your bequest, including our correct legal name. Finally, if you do plan to remember us in your will – or already have done so – please tell us!

WILL ESTATE TAXES AFFECT YOUR FAMILY'S SECURITY?

One of the primary aims of estate planning is to protect against estate "shrinkage" brought on by state death taxes, expenses of estate administration, lack of estate liquidity and, most important, the federal estate tax. The estate tax credit will shelter most estates, but you should keep in touch with your advisers if your estate may be depleted by state death taxes or income taxes on retirement accounts or savings bonds. Some people may be leaving a "hidden bequest" in estate taxes to the United States government . . . a bequest of perhaps 20% to 30% of their estates. This is a tax on your capital . . . a tax that can be levied on properties you may not even consider as assets owned by you.

Happily, it's possible to do something about the federal estate tax. Planning now to minimize the tax may save thousands of dollars for your beneficiaries. The first step, though, is to assess whether – and how badly – your estate will be affected by these taxes. So let's start by figuring what the approximate value of your estate might be.


A TAX WITH LONG TENTACLES

Everything you own, and some of the things you don't own,[4] may be subject to the federal estate tax – your stocks and bonds, your home, your business interests, your bank accounts, certain employee death benefits, your real property, even your wristwatch. And the tax will be imposed on the fair market value of your assets at the time of your death – not on the cost of the assets to you.[5]

In addition to the common assets we know we own, there are several surprise assets that can cause estate tax problems. For example, many people overlook life insurance as an asset. The full value of every insurance policy on your life will be subject to estate tax if you have any right to change beneficiaries, to borrow on the policies, to cash them in or to exercise any other incidents of ownership.[6] It doesn't matter whether such policies are group policies paid for by your employer, term insurance, accident insurance, retirement income policies or ordinary life policies. All will be taxable at your death.

In making a preliminary estimate of your potential estate tax liability, assume that one-half of all property owned jointly with your spouse will be taxable at your death. If the other joint owner is not your spouse, all the property may be taxed in your estate if you die first.[7]

There may be other surprises. Taxable gifts you make during life are added to your assets at death for purposes of computing the federal estate tax.[8] Gifts made within three years of death – and any federal gift tax paid on them – are sometimes included in your estate.[9] Further, property you never owned may be taxed if you had broad rights of control over it.[10]

ESTIMATING YOUR TAX LIABILITY

Add up the market value of your assets. For a quick estimate you may want to use this list.[11]

Stocks and bonds	$ ______________
Notes and debts due to you	$ ______________
Real property	$ ______________
Bank accounts and cash	$ ______________
Business interests	$ ______________
Personal property	$ ______________
Retirement death benefits	$ ______________
Life insurance	$ ______________
Employee death benefits	$ ______________
Jointly owned property[8]	$ ______________
Other taxable property	$ ______________
Total assets	$ ______________

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Note: The preceding list is made up of obvious assets; remember that there may be more, hidden assets.[12]

Next, from the value of your total assets you can subtract debts and mortgages payable by your estate. You can also subtract funeral costs and estate settlement costs, estimating such costs at about 8% of your total assets.[13] Finally, add in any taxable gifts you made after 1976.[8]

Total assets (gross estate)	$ ___________
Less debts and settlement costs	$ ___________
Plus taxable lifetime gifts[14]	$ ___________
Amount subject to tentative tax	$ ___________

LARGE EXEMPTIONS SHELTER MOST ESTATES

Congress has passed legislation that renews the federal estate tax for 2011 and 2012, but provides an exemption for taxable estates totaling $5 million or less. Up to $10 million can be sheltered by married couples. The maximum estate tax rate is now 35%. A $5 million exemption also now applies to federal gift tax and generation-skipping transfer tax, and the 35% top rate will apply to both of these taxes. All exemptions will be indexed for inflation after 2011.

The new $5 million exemption from estate taxes means that only a few thousand estates per year will be liable for estate tax. But everyone should remember that estate planning involves much more than estate taxes. All Americans need to plan for a thoughtful distribution of their assets at death, reduction of estate expenses such as probate, state death taxes, income taxes on retirement accounts – and leaving a legacy to future generations.

People who find that they are still subject to the federal estate tax are sometimes shocked by its severity. But through careful planning and taking advantage of several deductions that Congress has made available, estate taxes can be substantially reduced. This booklet discusses some of these techniques.

A word on state laws: Many states impose their own inheritance taxes or estate taxes. These taxes can affect individuals whose estates are not subject to federal estate tax. Your own situation will depend on:

- your place of legal domicile at the time of death, and
- the tax laws in other states where you own real estate or have personal possessions.

Some states have an *inheritance tax*, which is a tax levied on the right of heirs to receive property from a deceased person. It is imposed upon, and measured by, the share that each heir receives, as well as by the closeness of the relationship of the heir to the deceased. Other states have an estate tax, which is similar to the federal estate tax in that it is levied upon the transfer of the estate as a whole. In some states, the tax applies to estates lower than the federal exclusion. State taxes are deductible on the federal estate tax return. Ask your advisers about current state "death tax" laws in your area.

Be especially careful to check the death tax laws if you move to a different state. After you move, have an attorney check your will and trust arrangements. You may want to choose a new executor (personal representative at death) or trustee. Your old will probably is still valid, but updating it may greatly simplify probate and administration of your estate. If you are married and move into a new state, ask your advisers about local laws on property rights of spouses. Ownership of property that you and your spouse acquire in your new home state may be subject to different marital property laws.

WHAT IF YOUR ESTATE DOES FACE ESTATE TAX?

If the estimate of the size of your estate indicates that you will be affected by estate taxes, there are two deductions that might be available to reduce the amount of your taxable estate.

First, the marital deduction – The value of any property that passes to your spouse is 100% deductible. So a married person can leave any size estate totally tax free – if it all goes to the other spouse.[16] The marital deduction may only postpone the federal estate tax, however. If the surviving spouse does not remarry, there may be a large tax at his or her death.

Second, the charitable deduction – The value of any property that passes to any qualified charitable organization is deductible.[17] This deduction is allowed for both outright bequests and deferred bequests.

These deductions will be discussed more fully later in this booklet. But an example will show how important the deductions can be in your estate planning:

Mr. Black has an estate valued at $7,000,000. Debts and settlement costs amount to $560,000. If he were single, the tax on the estate could be significant. If Mr. Black were married, however, and bequeathed $50,000 for our benefit and the rest to his wife, his estate tax picture would be:

Gross estate	$7,000,000
Debts and costs	560,000
Marital deduction	6,390,000
Charitable deduction	50,000
Taxable estate	none

The tax savings resulting from the marital and charitable deduction is dramatic . . . absolutely nothing is owed the government.

PLANNING FOR MARRIED COUPLES

A surviving spouse now can "inherit" any unused estate tax exemption from the first spouse to die without the need for special trusts or other planning – if an election is made on an estate tax return filed for the first spouse. Thus, married couples together could shelter up to $10 million from federal estate tax. Only one "inherited" credit is permitted, however, even where a wife or husband outlives more than one spouse.

Before 2011, "credit shelter trusts" might have been necessary for married couples to take full advantage of both of their exemptions. These trusts may still be a good strategy in certain situations. For example, if a husband leaves $5 million to a credit shelter trust for his wife, the trust can be arranged so that all trust assets remaining at her death will pass to their children outside her estate. There would be no further federal estate tax, even where the $5 million had grown in value (to $7 million, for example). The credit shelter trust also can enable the first spouse to die to designate who will receive trust assets when the surviving spouse dies (such as children from a prior marriage).

Couples whose estates exceed the $10 million sheltered amount will need further planning, including family gifts, trusts and liquidity planning.

"QTIP" IS A GOOD TIP FOR MARRIEDS

Many married people know they can have tax-exempt estates if they leave everything to each other – but sometimes that can create problems. Take the case of Michael:

Michael was a widower for many years but eventually remarried and now is living in contented retirement with his new wife, Charlotte. He has eight grown children from his first marriage, all of them "on their own." Michael has three major estate planning concerns: (1) that Charlotte be financially secure after he dies, (2) that most of his estate pass to his eight children after Charlotte dies and (3) avoidance of all federal estate taxes at his death.

As much as Michael might trust Charlotte to leave the property to his children in her will, he worries that she may remarry and leave everything to her new husband. Instead, Michael could direct that most or all of his estate go into a QTIP (Qualified Terminable Interest Property) trust from which the trustee would pay Charlotte only the trust income for life, then distribute everything to the children.

The legal effect is that he can "lock in" his children as the beneficiaries of the trust when she dies – and everything in the trust will qualify for the marital deduction. (His executor must elect this "QTIP" treatment.)[18]

The "QTIP" arrangement helps in one's personal planning and saves taxes at the death of the first spouse . . . but note that there still may be a very large tax when the surviving spouse dies. So it may not make sense to leave everything to your spouse from a tax standpoint, or from a personal standpoint, for that matter. Many married people conclude, upon reflection, that there are others they should benefit – including worthwhile causes – and that doing so will not jeopardize their spouses' security.

JOINTLY HELD PROPERTY OF MARRIED COUPLES

Property you own jointly with another, with rights of survivorship, does not pass under the terms of your will. Instead, such property passes automatically to the surviving owner. Large numbers of people, especially husbands and wives, routinely hold most of their property "in joint names." But what will happen to their property if they both die about the same time? The property of the latter to die will be disposed of according to the state law. Joint ownership also has estate tax and income tax implications.

Only one-half of the value of jointly held property of married couples is includible in the estate of the first spouse to die, regardless of which spouse furnished the consideration for its purchase.[19] Further, property can be placed in joint names during life without gift tax problems. But surviving spouses now may have increased *income tax* liabilities.

Suppose you inherit property from your spouse for which he or she paid $10,000 originally, but which is worth $100,000 at the spouse's death. If you later sell the property for $100,000, there won't be any capital gains tax, since the tax laws currently allow you a new, "stepped-up" basis equal to the $100,000 date-of-death value, rather than the $10,000 cost basis in effect during the spouse's lifetime.

Now suppose that your spouse had the property placed in your "joint names." In many states you will get a stepped-up basis in only half the property . . . and face a $45,000 capital gain if you sell for $100,000. Ask your advisers if you will be affected.

Comment: Jointly owned property may not be the best idea for your estate plan under the current tax laws, especially for property that is likely to increase in value. Ask your advisers what's best for your case.

LIFE INSURANCE REQUIRES CAREFUL PLANNING

It's vital that you integrate your life insurance policies with your overall estate plan. Remember that the full face value of any life insurance policy in which you keep ownership rights will be subject to the federal estate tax.[6] It may make good tax sense to give a policy of insurance on your life to the beneficiary, or to another member of your family. Such a gift generally will keep the policy proceeds out of your estate. But bear in mind that the gift must be absolute and irrevocable. If you can foresee a possibility that you will need the policy for your own security, giving the policy away could be risky. By the same token, if it's possible that you may one day regret your choice of beneficiary, it might be better to forgo the estate tax savings and keep the policy.

Life insurance can be extremely helpful in many areas of estate planning. It can help provide liquidity in your estate, or fund a trust that will provide, after your death, a lifetime income for your spouse, with the principal later going to your children – or even as a tax-favored deferred bequest for our benefit.

Note, too, the role that life insurance can play in your philanthropic planning. An unneeded life insurance policy can be given new purpose and meaning as a charitable contribution. Take the case of a husband who makes his wife the beneficiary of a policy on his life, but the wife dies before him. Such a policy could serve as a fine memorial gift. Life insurance can also provide a way to arrange a truly significant gift for our benefit by means of a series of modest premium payments – all tax deductible. Call us for details on life insurance gifts.

FAMILY GIFTS ARE IMPORTANT

Lifetime gifts to family members can

provide significant tax savings and present satisfaction. You can make separate gifts of up to $13,000 each year to as many different people as you choose and owe no federal gift tax. More important, you will remove these amounts from your estate and save federal estate tax. A married couple can "split" gifts between them and increase the tax-free amount to $26,000 per year, per donee. How much can you save in estate taxes? Suppose you have six beneficiaries to whom you had planned to leave $26,000 each in your will. In a taxable estate these six $26,000 bequests would be taxed at a high tax rate. But you could totally avoid this tax by simply giving each beneficiary $13,000 a year for two years during your lifetime.

ARRANGE FOR "ESTATE LIQUIDITY"

You should make certain that your estate has enough liquid assets to cover expenses of administration, state death taxes and the federal estate tax – which is generally payable in cash within nine months of death.[20] Without a ready pool of cash to draw from, an executor might be forced into an untimely sale of some of your assets. An irrevocable trust is an excellent way to provide your executor with the necessary estate liquidity. Property that is readily convertible to cash – or life insurance sufficient to meet settlement costs – is transferred to the trust. The trustee is then permitted to buy property from the executor, or make loans to him or her to meet estate expenses – and the value of the trust will not be taxable in the estate.

PLAN FOR DISPOSING OF YOUR BUSINESS INTERESTS

Business owners have special planning needs and opportunities. What will – or should – happen to the business after an owner's death? How will estate taxes on the business interest be paid? As a business owner you ought to consider a buy-sell agreement with your co-owners that will preserve continuity for the business enterprise and create a source of cash to meet the debts and tax obligations of your estate. Stockholders in closely held corporations may be eligible for the special "Section 303 redemption" tax break that can permit tax-free redemption of part of their stock for the purpose of paying funeral expenses, death taxes and estate administration costs. There are special estate tax breaks available for farmers and business owners when it comes to real estate valuation[21] and exclusions where the business constitutes more than 50% of the estate – although very strict tests must be met in order to qualify. Furthermore, the estate tax attributable to farms and closely held business interests may be deferred for five years and then paid in ten annual installments.[22] But again, careful planning is necessary.


INCOME TAXES AND ESTATE PLANNING

Certain items that pass at death, known as “income in respect of a decedent (IRD),” carry an income tax liability for your heirs. Examples include accounts receivable of a professional, government savings bonds, IRAs and other retirement assets. It makes sense to leave these items to persons in low tax brackets. Better yet, leave IRD to a tax-exempt organization such as ours. We would keep every dollar of such a bequest.

TRUSTS CAN BE VITAL IN ESTATE PLANNING

Some of the possibilities for using a trust in your estate planning have already been mentioned. Indeed, a trust may well play an important role in your own plans. Consider some of the things that a trust, created during life or in your will, can accomplish:

- Income for your family – free of investment worries;
- State or federal estate tax savings, usually achieved through a family trust designed to provide broad benefits to your surviving spouse but restricted just enough to prevent the trust assets from being taxed at his or her death;[25]
- Continued control by you, the creator of the trust, over distribution of income, how and when principal will be paid, who will be the beneficiaries, rules and procedures for the trustee to follow in administering the trust and other important matters;
- Dual benefits for your family and our programs – all accomplished in the context of meaningful tax savings.

ESTATE PLANNING, UNITRUSTS AND MARRIED COUPLES

A unitrust can make good sense in a married person’s estate plan. If the unitrust is established while both spouses are still alive, they can have substantial financial and income tax benefits. Also, married people who create unitrusts will receive full advantage of the 100% gift tax or estate tax marital deduction if they name their spouses as life income beneficiaries. Thus, a husband can set up a unitrust for his wife (or for both of them), and his entire estate could pass estate tax free at his death, assuming his wife receives everything. At her death the contents of the unitrust will pass to charity free of federal estate tax. Alternatively, the husband could establish a “QTIP” trust, discussed earlier, in which his wife would receive all the income for life, with some or all of the trust assets passing to charity at her death. The wife’s estate would be entitled to a charitable deduction for any amounts passing to an organization such as ours.


A FINAL WORD

We would be pleased to provide further information on how any gift, bequest or charitable trust for our benefit can be a part of your thoughtful estate planning. Please call our office!

NOTES FOR TAX ADVISERS

1. Trusts, life insurance and property ownership arrangements also can be good estate planning tools – but a will is the "centerpiece" of most estate plans.
2. A will is not a "do-it-yourself" project because of the technicalities required for a valid will.
3. Each state has its own special rules as to how the estate of a person who has died "intestate" (without a will) will be divided.
4. IRC, §2033 taxes all property to the extent of the decedent's interest in such property at the time of his or her death.
5. IRC, §2031. An estate can be valued as of six months after the death if the executor so elects (IRC § 2032).
6. IRC, §2042. Even if you have no ownership rights in a policy, proceeds payable to or for the benefit of your estate will be taxed.
7. IRC, §2040. Where joint owners are not married to each other, the estate tax results depend on the nature of the ownership, the time when the property was acquired, how the purchase price was paid and the manner in which the property was acquired.
8. IRC, §2001(b) requires that the tentative tax be computed on the sum of the taxable estate and the amount of the adjusted taxable gifts. From this amount is subtracted the gift tax paid on gifts made after 1976.
9. IRC, §2035. Gifts of life insurance and gifts with retained interests made within three years of death are included in the gross estate.
10. Property subject to a decedent's general power of appointment is generally subject to the estate tax even though he or she does not exercise the power (IRC, §2041).
11. The purpose of the estimate is to give you a very general idea of where you stand in relation to the estate tax. You need competent tax and legal advice, of course, for a reliable appraisal. Do-it-yourself estate planning is dangerous and not recommended.
12. See notes 9-11, supra, and the text to which they apply.
13. IRC, §2053. See also IRC, §2054.
14. Taxable lifetime gifts made after 1976, under the unified rate schedule then in effect, are generally computed in determining estate tax liability (IRC, §2001).
15. IRC, §2010. In addition to the federal estate tax credit, a credit is also allowed for foreign death taxes (IRC, §2014) and the tax on prior transfers (IRC, §2013). A gift tax credit is also available, sheltering gifts made during life up to $5 million.
16. IRC, §2056. The marital deduction is available only for property that is actually transferred to a spouse at death.
17. IRC, §2055.
18. IRC, §§2044, 2056(b)(7).

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19. IRC, §2040.
20. Extensions on the filing deadline can be obtained for "reasonable cause." IRC, §6161(a).
21. IRC, §2032A.
22. IRC, §6166.
23. But trusts can't avoid estate taxes indefinitely. A "generation-skipping" tax is provided for in IRC, §2611, after 2010. The tax is on trusts and other arrangements that cause property to "skip" to a new generation free of estate tax. An exemption equal to the estate tax credit shelter is allowed to the transferor.

The materials contained in this booklet are intended to show only some of the ways you can benefit our future and minimize your federal tax liability – with examples of anticipated federal tax liability. Thus, you should not take any action without first consulting your attorney.

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