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Life Advice About.... Estate Planning

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If you'd like to ensure your assets are distributed as you'd like them to be when you die, estate planning is the answer. Successful estate planning transfers your assets to your beneficiaries quickly and with minimal tax consequences. Estate planning can also assure that family members know how you'd like your financial and medical affairs to be handled if you become incapable of making your own decisions.

The process of estate planning includes inventorying your assets; talking over important decisions with family members; and making a will and/or establishing a trust. This brochure provides only a general overview of estate planning. You should consult an attorney, and perhaps a CPA or tax advisor, for additional guidance tailored to your specific situation.

[Do I Need to Worry?](#)

You may think estate planning is only for the very wealthy. But whether or not you have sizeable financial assets, it's likely you have possessions that have significant value to you and to those you care about - the china your great, great grandparents brought with them when they immigrated, or the Bible that has been handed down in your family for generations.

Certainly, if your assets are worth \$2,000,000 or more, estate planning can benefit your heirs by minimizing the taxable portion of your estate. Remember, *all* of your assets are included in your estate, and adding up the value of your assets can be an eye-opening experience. When you include your home, investments, retirement savings, and life insurance policies you own, you may be surprised at the value of your estate.

[Taking Stock](#)

A good first step in estate planning is to inventory everything you own (i.e., your assets) and assign a value to each asset. The following list can help you get started, but you'll probably need to add some categories and delete others.

- Residence
- Other real estate
- Savings, e.g., savings accounts, CDs, money markets
- Investments, e.g., stocks, bonds, mutual funds
- Pension and/or other retirement accounts, e.g., 401(k), IRA
- Life Insurance policies and annuities
- Ownership interest in a business
- Motor vehicles, e.g., cars, boats, planes
- Jewelry
- Collectibles, e.g., art, antiques
- Other personal property

Depending upon your specific situation, you may need professional advice (e.g., a real estate or antiques appraiser) to determine realistic values. Once you've estimated the value of your assets, you're ready to do some planning.

Making a Will

Why You Need a Will

A will is a legal document designating the transfer of your property and assets after you die. Although creating a will is not a difficult process, about half of all Americans die without one. If you die without a will, or *intestate*, the court steps in and distributes your property according to the laws of your state, which may or *may not* coincide with your wishes. If you have no apparent heirs and die without a will, it's even possible the state will claim your estate. Remember, wills are not just for the rich; your will ensures that whatever your assets, they will go to family members or other beneficiaries you designate.

Probate is a legal term, which means to "prove" a will. During probate, the court determines that your signed will is a genuine statement of how you want your estate to be distributed. Depending upon the state in which you reside, the probate process may take a few days or it may take many months, and depending upon the complexity of the will, it can be an expensive process. Careful planning can help stream line or avoid the probate process. For example, life insurance does not have to go through probate and can be disbursed directly to your beneficiaries. A qualified financial planner or estate attorney can help you determine what's appropriate for your specific situation.

Each state has specific requirements, but in general, a will can be written by any person over the age of 18 who is mentally capable - commonly stated as "being of sound mind and memory." Although it may seem like something you can do yourself, it may be best to consult an attorney for help when creating a will, especially if:

- You expect to owe estate tax at your death (see "[How Estates are Taxed](#)").
- You foresee any disagreement among your heirs or beneficiaries.
- You have children from more than one marriage, or a blended family.
- You own property in another state.
- You want to establish a trust (see "[Minimizing Estate Taxes](#)").

To be valid, a will must comply with the laws of the state in which you live. Only about half the states recognize "homemade" wills. State law may stipulate that you use specific language, sign the will in a particular way, and/or have a certain number of witnesses of a certain age present when you sign.

Bear in mind that having a will is especially important if you have young children because it gives you the opportunity

to designate a guardian for them in the event of your death. Without a will, the court will appoint a guardian.

Elements of a Will

Basic elements of a will include:

- Your name and place of residence.
- A brief description of your assets.
- Names of spouse, children, and other beneficiaries, such as charities or friends.
- Alternate beneficiaries, in the event a beneficiary dies before you do.
- Specific gifts, such as an auto, residence, or family heirlooms.
- Establishment of trusts, if desired.
- Cancellation of debts owed to you, if desired.
- Name of an executor to manage the estate.
- Name of a guardian for any minor children.
- Name of an alternative guardian, in the event your first choice is unable or unwilling to act.
- Your signature.
- Witnesses' signatures.

Probably the most important considerations when making your will are naming a guardian for your minor children and naming an executor.

Naming a Guardian

If you die while your children are still minors or you have children who cannot care for themselves in adulthood, you'll want them to have the best possible care in your absence. Making a will gives you the opportunity to select the person you believe can provide that care. The guardian you choose should be over 18. Before naming a guardian, talk to the person you'd like to name to make sure they are willing to assume the responsibility. Name an alternate guardian as well, who can take over if the primary guardian is unable or unwilling to fulfill the responsibility. This is especially important if your children are young or will require life-long care. If you do not name a guardian to care for your children, a judge will appoint one, and it may not be someone you would have chosen.

Although it is legal to name a couple as co-guardians, it may not be advisable. It's possible the couple may choose to go their separate ways at some later date, and, if so, a custody battle could ensue.

Naming an Executor

The person who carries out or *executes* the instructions in a will is called an *executor*. Obviously, your executor should be an individual you trust. Most people choose their spouse, an adult child, a relative, a friend, or a trust company or attorney to fulfill this duty. Choose someone who can handle all of the financial matters involved with settling your estate, and check with that person ahead of time to make sure they are willing to assume the responsibility. Some states stipulate that the executor must be a state resident. It's a good idea to appoint an alternate executor in case the first person you name is unable or unwilling to fulfill the responsibility. The responsibilities of an executor generally include:

- Collecting your assets.
- Paying creditors.
- Paying taxes.
- Notifying Social Security and other agencies and companies of the death.
- Canceling credit cards, magazine subscriptions.

- Distributing assets according to the will.

While you can specify in your will that an executor waive payment in order to be eligible to serve as executor, this is only suitable if the person named is a beneficiary of the estate or a very close personal friend, since being an executor is time consuming. You should expect your estate to pay an independent executor for this service. Banks or trust companies will not serve as executors of estates unless entitled to payment. If no executor is named in a will, a probate judge will appoint one, most often a bank or an attorney. This will likely increase the cost.

Put It in Writing

An inventory of your assets is a good start, but it's not the only information you need to create a will. You also need a list of family members and other beneficiaries (e.g., charities) that you may mention in your will, an estimate of your outstanding debts, and an outline of your objectives (e.g., to provide college tuition for my grandchildren). Use this information to consider how you want to distribute your assets.

Ask yourself lots of questions: Is it important to pass my property to my heirs in the most tax-efficient manner? How much money will my grand child need for college? Do I need to provide for a child who has a disability? An attorney familiar with estate planning will help you identify the questions and guide you in determining the answers.

Specific bequests are those in which you name a specific beneficiary to receive a specific sum of money or a specific item or property (e.g., \$10,000; my furnished residence at 10 Elm St.; my entire coin collection). Specific bequests may also be made to charities, although the tax consequences of the two maybe different.

Be as specific as possible when naming beneficiaries. For example, state the person's full name as well as his or her relationship to you (child, cousin, friend) so your executor will know your intentions. Clarity will help to prevent challenges to your will.

Items not specifically mentioned need to be addressed in a catch all clause of your will called a **residuary clause**, which generally states, "I give the remainder of my estate to.. ." Without this clause, items not specifically mentioned will likely be distributed in accordance with state law.

Note that the estate usually pays outstanding debts before beneficiaries receive their shares. You may want to clear up debts that you think maybe a problem, or make specific provisions for payment of those debts in your will.

States require that you sign the will in front of witnesses; the number of witnesses varies by state. Witnesses should not be beneficiaries of the will, and only one copy should be signed.

If you need help finding a qualified estate planning attorney, the website of the American Bar Association (www.abanet.org) has information to help you find one, although they will not make specific recommendations. See "[For More Information.](#)"

Estate Taxes

How Estates Are Taxed

Federal gift and estate tax law permits each tax payer to transfer a certain amount of assets free from tax. These assets may be transferred during his or her lifetime or at death. In addition, certain gifts valued at \$12,000 or less can be made that are not counted against this amount (see "[Minimizing Estate Taxes](#)"). The amount of money that can

be shielded from federal estate or gift taxes is determined by the unified credit. A credit is an amount that eliminates or reduces tax. The unified credit applies to both the gift tax and the estate tax. You subtract the unified credit from any gift tax that you owe. Any unified credit you use against your gift tax in one year reduces the amount of credit you can use against your gift tax in a later year. The total amount used against your gift tax reduces the credit available to use against your estate tax.*

*www.irs.gov, [Estate and Gift Taxes](#), Unified Credit.

The chart following shows, by year, the dollar amount of your estate excluded from federal taxes and the tax rate on the taxable portion of an estate. Note that rates are as high as 46 percent for the taxable portion of the estate.

[table]

Exclusion Year	Highest Amount	Estate Tax Rate
2006	\$2,000,000	46%
2007	\$2,000,000	45%
2008	\$2,000,000	45%
2009	\$3,500,000	45%

Keep in mind that while you can plan to minimize taxes, your estate may still pay some federal estate taxes. Also, your estate may be subject to state estate or inheritance taxes, which are beyond the scope of this pamphlet. Consult an estate planning professional or attorney for more specific information about federal estate taxes and state taxes.

Minimizing Estate Taxes

There are a number of estate planning methods you can use to minimize federal taxes on your estate. Brief overviews of some of these planning tools are outlined in the following paragraphs.

Giving away assets during your lifetime. Federal tax law generally allows each individual to give up to \$12,000 (scheduled to be adjusted periodically for inflation) per year to anyone, without paying gift taxes, subject to certain restrictions. That means you can transfer some of your wealth to your children or others during your lifetime to reduce your taxable estate. For example, you could give \$12,000 a year to each of your children, and your spouse could do likewise - for a total of \$24,000 per year to each child. You may make \$12,000 annual gifts to as many people as you wish. You may also give your child or another person more than \$12,000 a year without having to pay federal gift taxes, but amounts in excess of \$12,000 will count against the amount shielded from tax by your applicable credit. For example, if you gave your favorite niece \$33,000 a year for the last three years, you would have reduced your applicable credit by \$63,000 - a \$21,000 excess gift each year.

Using the marital deduction to shield property from taxes. Federal tax law generally permits you to transfer assets to your spouse without incurring gift or estate taxes, regardless of the amount. This is *not*, however, without its drawbacks. Marital deductions may increase the total combined federal estate tax liability of the spouses upon the subsequent death of the surviving spouse. To avoid this problem, many couples choose to establish a bypass trust.

Bypass trusts or credit shelter trusts can give a couple the advantages of the marital deduction while utilizing the applicable credit to its fullest. Let's say, for example, that a married couple has a federal taxable estate worth \$3,000,000 million (or \$1,500,000 each). Using the marital deduction, if one spouse dies in 2006 the full \$1,500,000 can be left to the other spouse without incurring taxes. But if the second spouse dies in 2007 and passes his or her

\$3,000,000 estate on to their children, taxes will be levied on the excess over the amount of assets shielded by the applicable credit (\$3,000,000 - \$2,000,000 = \$1,000,000 subject to estate tax).

With a bypass or credit shelter trust, the first spouse to die can leave the amount shielded by the applicable credit to the trust. The trust can provide income to the surviving spouse for life; then, when the surviving spouse dies, the assets are distributed to beneficiaries, such as children. This permits the spouse who dies first to fully utilize his or her applicable credit. If the trust document is drawn properly, the assets in the trust are *not included* in the surviving spouse's estate. Thus, the surviving spouse's estate will be smaller and can also utilize the applicable credit. In the example above, the surviving spouse's estate would not have to pay federal estate taxes. Because both partners have made use of their applicable credit, the couple is able to pass on a substantial estate to their beneficiaries, tax free.

Charitable gifts are not taxed as long as the contribution is made to an organization that operates for religious, charitable or educational purposes. Check to see if the organization you want to give money to is an eligible charity in the eyes of the Internal Revenue Service. You, or your estate, maybe entitled to a tax deduction for contributions to a qualifying charity. Consult your tax advisor for specific details.

Life insurance trusts can be designed to keep the proceeds of a life insurance policy out of your estate and give your estate liquidity. Generally, you can fund a life insurance trust either by transferring an existing life insurance policy or by having the trust purchase a new policy. (Note that transferring an existing policy may have gift tax consequences - consult your tax advisor.) To avoid inclusion in your estate, such trusts must be irrevocable- meaning that you *cannot* dissolve the trust or change the terms of the trust if you change your mind later. With proper planning, the proceeds from life insurance held by the trust may pass to trust beneficiaries without income or estate taxes. This gives them cash, which may be used to help pay estate taxes or other expenses, such as debts or funeral costs.

Estate planning is very complex and is subject to changing laws. This pamphlet does not cover all aspects of estate planning. Be sure to seek professional advice from a qualified attorney, and perhaps a CPA. The money you spend now to plan your estate can mean more money for your beneficiaries in the end.

Who Will Manage Your Affairs If You Cannot?

Everyone faces the possibility that sometime during their lifetime, they may become incapacitated. This can happen when an individual is nearing death, but it can also be the result of a temporary condition. Many people assume their spouses or children will automatically be allowed to make financial and/or medical decisions for them, but this is not necessarily so.

Powers of Attorney

A *power of attorney* is a legal document that allows one person (called the principal) to appoint someone else - called the agent or *attorney-in-fact* - to act on his or her behalf. The powers that can be exercised by the agent can be broad or narrow; the principal stipulates them, in advance. You might, for example, authorize your agent to do a specific thing (e.g., sell your house) or you might give the authority to do any legal act you would do yourself. If you become incapacitated and don't have a power of attorney, your family may have to go through lengthy and expensive legal action so that someone can act on your behalf. There are three different types of powers of attorney:

- A *conventional* power of attorney gives the agent whatever powers the principal chooses for a specific period of time (e.g., 30 days) beginning when it is signed.
- A *durable* power of attorney stays in effect for the principal's lifetime - beginning when it is signed. This power of attorney **must contain specific languages stating the agent's power is to stay in effect even if the principal becomes incapacitated.**
- A *springing* power of attorney is triggered by a specific event, such as when the principal becomes

incapacitated. **An attorney must carefully draft this type of power of attorney so that there is no difficulty determining when the springing or triggering event has occurred.**

For estate planning purposes, a durable power of attorney is usually the recommended choice, since conventional powers of attorney expire, and it can be difficult to determine exactly when springing powers of attorney take effect. Good planning dictates that you have two powers of attorney - one for financial matters, and another to deal with medical issues; you can, if you choose, select the same agent to perform both duties.

Signing a power of attorney does not mean you can no longer manage your own affairs. You are not giving up your right to act in your own behalf; you are ensuring that your agent will be able to act when and how you have directed, *if* it becomes necessary. Also, it's important to note that you can revoke, or cancel, a power of attorney at anytime. You can destroy it or make a new one, and you do not need to give a reason for doing so. If you do make changes to your power of attorney it is a good idea to let all involved parties know of your decision - particularly your appointed agent and anyone they may be dealing with, as well as your attorney.

All powers of attorney automatically end when the principal dies. This means that after you die, your appointed agent will have no power to make decisions. Consequently, your agent's powers do not overlap with those of the executor of your estate.

Choosing a power of attorney agent is an important decision; you need to trust the person completely, and you need to make sure they are capable of performing the job. Make sure that the person you choose is willing to assume the responsibility. If you come up with a choice of more than one qualified individual, it might be a good idea to choose the one who lives nearest to you. Discuss your options with an estate planning attorney.

Planning Your Medical Care and Treatment - Advance Directives

Advance directives are written documents that tell your doctors what kind of treatment you'd like to have if you become unable to make medical decisions (e.g., if you're in a coma). They can take many forms, and the laws about them vary from state to state. It's a good idea to understand the laws of the state where you live when you write advance directives. It's also a good idea to make them before you are very ill. Federal law requires hospitals, nursing homes, and other institutions that receive Medicare or Medicaid funds to provide written information regarding advanced care directives to all patients upon admission.

Living wills are a kind of advance directive that come into effect when a person is terminally ill. A living will does not give you the opportunity to select someone to make decisions for you, but it allows you to specify the kind of treatment you want in specific situations. For example, you might choose to specify that you do not want to be treated with antibiotics if death is imminent. A Do Not Resuscitate order (DNR) is a type of advance directive specifying that if your heart stops or if you stop breathing you are not to be given cardiopulmonary resuscitation (CPR). It is standard procedure in hospitals to try to help all patients who have stopped breathing or whose heart has stopped. You can, if you choose, tell your doctor you do not wish to be resuscitated and a DNR order will be entered on your medical chart.

A **durable power of attorney** for health care (sometimes called a durable medical power of attorney) specifies whom you've chosen to make medical decisions for you. It is activated anytime you're unconscious or unable to make medical decisions. You need to choose someone who meets the legal requirements in your state for acting as your agent. State laws vary, but most states disqualify anyone under the age of 18, your health care provider, or employees of your health care provider.

The person you name as your agent must:

- Be willing to speak and advocate on your behalf.

- Be willing to deal with conflict among friends and family members should it arise.
- Know you well and understand your wishes.
- Be willing to talk with you about these issues.
- Be someone you trust with your life.

Make sure to let family members and close friends know whom you've chosen as your agent. Your spiritual or religious beliefs may have bearing on the types of advance directives you choose to prepare. Although death is often a difficult subject to bring up, it is a good idea to discuss these issues with family members to ensure that they understand your values and beliefs. The more communication you have with family members, the easier it will be for them to respect your wishes. Also, if you've decided to be an organ donor, make sure that your agent and your family know and that you include the information in a medical directive.

Advance directives don't have to be complicated legal documents; they can be relatively short statements about what you want done if you can't speak for yourself. Any advance directive must, however, comply with state laws. It's also a good idea to have written advance directives reviewed by your doctor and your lawyer to make sure that your instructions are understood as intended. Once you've finalized advance directives, give copies to your family, medical power of attorney agent, and your doctor.

Fine Tune Your Plans Periodically

Estate planning is not a one-time job. There are a number of changes that call for a review of your plan. Take a fresh look at your estate plan if:

- The value of your assets changes significantly.
- You marry, remarry, or divorce.
- You have a child or new grandchild.
- You move to a different state.
- The executor of your will or the administrator of your trust dies or becomes incapacitated, or your relationship with that person changes significantly.
- One of your heirs dies or has a permanent change in health.
- Your children reach age 18.
- The laws affecting your estate change.

You'll probably need to update your will several times during the course of your life. Things change as time passes. For example, once your children are grown and have their own families, you may want to make provisions for grandchildren. When you make a new will, be sure to destroy the old one after the new one is signed, dated, and witnessed. You can also update your will by adding a codicil - an addition or change. If you add a codicil to your will, make sure it is witnessed, signed, and dated, and attached to all copies of your will. Consult an estate attorney for advice specific to your situation.

For More Information

Free Publications

The quarterly *Consumer Information Catalog* lists more than 200 helpful federal publications. Obtain a free copy by calling 888-8-PUEBLO; on the Internet at www.pueblo.gsa.gov or by writing:
Consumer Information Catalog
Pueblo, CO81009

Websites

www.aarp.org

This website offers free, useful information on estate planning. A free will preparation worksheet can be downloaded at www.aarp.org/families/legal_issues/legal_guides/a2004-03-25-will.html

www.irs.gov

Internal Revenue Service website has up-to-date state tax information

www.abanet.org

Website of American Bar Association (ABA) offers information on finding and using an estate planning attorney. The ABA does not make referrals. Click on **Find Legal Help**. The **ABA Commission on Law and Aging** offers a free tool kit for advance planning / medical directives. It can be downloaded at: www.abanet.org/aging/publications/docs/consumer_tool_kit_bk.pdf

www.freeadvice.com

Free, comprehensive, easy-to-understand legal information.

www.csrees.usda.gov/fsll

Click on "**Tools for Consumers**" for online learning to help you achieve financial security for yourself and your family.

www.MyMoney.gov

The Federal Government's website dedicated to helping Americans understand more about their money.

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