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WHY ESTATE PLANNING IS STILL IMPORTANT

With the federal gift and estate tax exemption currently at $5.25 million per person ($10.5 million for married couples), some clients and potential clients with "smaller" estates may wonder if they need *any* estate planning. But there are many reasons to do estate planning other than to avoid estate taxes. In fact, for most Americans, the recent tax legislation has brought incredible freedom. Instead of jumping through hoops to avoid estate taxes, planners can now concentrate solely on the real reasons clients need to do estate planning: to take care of themselves and their families the way they want.

In this issue of *The Wealth Counselor*, we will examine why proper estate planning is still important, regardless of the size of a client's estate. We will also address issues to consider for those clients who already have plans in place.

Avoid State Inheritance/Death Taxes

It is true that, with the larger federal estate tax exemption in place, most families will not have to pay federal estate tax. But many states have their own inheritance/death tax. And while the states' tax rates are generally lower than the federal tax rate of 40%, they typically apply at a much lower threshold. This means an estate could be exempt from federal tax but have to pay a state tax. Proper estate planning can reduce or even eliminate state inheritance/death taxes.

Ensure Assets Are Distributed the Way the Client Wants

Everyone has an estate plan. It is either the one we have created or the default plan of the state in which we live. In our experience, it is very unlikely that a state's default plan is what clients would want. State laws vary, but generally they have assets go outright to the closest family members; whom a state considers to be "closest" often is complicated in non-nuclear families. Non-family members, like an unmarried partner, will not receive any of the assets.

Avoid Probate

For those who don't have a plan, their assets will probably have to go through a court process called intestate ("no will") probate. For those who have a will, the assets it controls will have to go through probate before they can be fully distributed to the heirs. Probate proceedings vary from state to state, but many view the time, cost, and loss of privacy and control that come with probate as unnecessary evils that should be avoided.

Even with a will, it is probable that not all of the assets will go through probate. Assets with a valid beneficiary designation pass outside probate to whomever the client has named as beneficiary(ies), and property owned jointly with right of survivorship will automatically transfer to the survivor. But if the beneficiary or joint owner is a minor or is incapacitated

when the client dies, the court will get involved to protect their interests. If the beneficiary or joint owner has died before or simultaneously with the client, or the designation/title is otherwise invalid, those assets will have to go through probate and will be distributed according to the will or, absent a will, the default state law.

Many older people add an adult child to the title of their assets (especially their home) as joint owner, often to avoid probate. But this can create all kinds of problems:

* When a joint owner is added, the original owner loses control:
  * Jointly-owned assets are exposed to the joint owner's possible misuse of them;
  * Part of these assets could be lost to the joint owner's creditors;
  * The assets could become part of a joint owner's divorce proceedings.
* There could be gift and/or income tax issues.
* It's easy to add a joint owner, but taking someone's name off the title can be difficult. If they do not agree, the original owner could end up in court.
* If the owner has more than one child but only names one child to be joint owner, fluctuating values and sibling discord could cause the children to receive unbalanced/unintended inheritances.
* Joint ownership does not provide any asset protection to the joint owner after the original owner dies.

Planning Tip: Probate can often be avoided by using joint ownership and beneficiary designations, but, in our experience, it most often leads to unintended consequences and has unintended risks. A better way to avoid probate is to establish and fully fund a revocable living trust. With a living trust, the trust maker keeps control over the assets, avoids uncertainty and unintended consequences, and avoids the risks associated with joint ownership. That's why a living trust plan often is preferred by many clients and professionals alike.

Provide Responsibly for Minor Children or Grandchildren

If any of the heirs are minors and the parent or grandparent has not made an estate plan, a court will control the minors' inheritances until they reach legal age (usually 18), at which point the heir will receive, in cash, whatever is left to spend as they see fit. For most eighteen year olds, that is a recipe for disaster!

In most states, a parent may nominate a guardian for minor children in a will or by a separate document. If both parents die before a child reaches legal age, the court will have to decide whether to accept the nomination or appoint someone to raise that child. If the last parent to die has made no nomination, the court will act without knowing whom the parent would have chosen.

On the other hand, establishing a trust for the children's or grandchildren's inheritance lets *the trust maker* (not some court) keep control of the inheritance, decide when each child or grandchild will receive it, determine what controls will be put in place to protect the beneficiaries' inheritance from themselves and others, and select someone the trust maker knows and trusts to manage it.

Protect Inheritances from Creditors and Predators
Gifted or inherited assets are protected from the courts and the beneficiary's creditors, divorce proceedings and irresponsible spending *only* if they are held in a trust with proper safeguards built into it. In a trust, the trust maker can instruct the trustee to make distributions as needed to trust beneficiaries, which can include his/her spouse, children and grandchildren.

Provide for a Second Spouse *and* Your Children
Planning in a second or subsequent marriage is often different from planning in a first marriage. There may be *his* children, *her* children and sometimes *their* children. Each spouse probably brought assets into the marriage, and each may want those assets to go to their own children after they die. At the same time, each spouse probably would want to make sure their surviving spouse will have enough to live on.

Naming a spouse who is not the parent of all of the children as a joint owner or beneficiary of life insurance or retirement accounts can be a problem because that means the spouse will have control of the proceeds if the parent-spouse dies first. Promises may be made now to include the children that are not the surviving spouse's children, but that may not work out if the parent-spouse is the "glue" holding these children and their stepparent together.

Planning Tip: Lifetime trust planning is often the best solution. Through a trust, the trust maker can provide his/her spouse with lifetime income (or income until remarriage), yet keep control over to whom, when and how whatever assets are not needed for that purpose are distributed.

Provide for a Loved One with Special Needs
Often there is a spouse, child, sibling, parent or other loved one who is physically, mentally or developmentally disabled—from birth, illness, injury or even substance abuse—who may be entitled to government benefits now or in the future. Most of these benefits are available only to those with very minimal assets and income. A non-structured inheritance often disqualifies a disabled person from receiving government benefits that are needed for his/her care.

Planning Tip: A special needs trust can provide for a loved one without jeopardizing valuable government benefits. It is carefully designed to *supplement* and not jeopardize the benefits

provided by local, state, federal or private agencies.

Plan for Disability
If a person can't conduct business due to mental or physical incapacity (dementia, stroke, heart attack, etc.), having a will won't help. This is because a will can only deal with what happens after someone dies. If there is a problem with a power of attorney, the person doesn't have one, or someone (like a bank) that has the person's assets will not accept it, a probate court will have to appoint a guardian to manage those assets for this person's benefit. Then a court, not the family, will control how the assets are used to care for this person. That will continue until the person dies or recovers. The guardianship process is public and can be expensive, embarrassing, time consuming and difficult to end. It does not replace probate at death, so the family could have to go through the probate court twice.

Planning Tip: Sometimes a power of attorney will not be accepted by whoever has control of the assets. That, and the fact that a living trust will provide detailed instructions and directions that a power of attorney will not, is why a living trust is much preferred to reliance on a power of attorney in the event of incapacity.

Health care documents are critical. We need to give someone the power to make health care decisions for us if we are unable to make them for ourselves. A living will can speak for us if we are unable and tell the doctors whether we want to be kept alive in a vegetative state or allowed to die. Federal and state laws control to whom doctors can disclose our medical situation in the absence of written direction, so we need to give those directions while we are able.

Finally, the exorbitant costs of long-term care, most of which are not covered by health insurance or Medicare, can wipe out a lifetime of savings. Long-term care insurance should be considered to protect assets.

Protect A Business and Other Assets
Those in high-litigation-risk fields like construction, medicine, law and real estate must be concerned about protecting their assets from lawsuits. All business owners need to plan for what will happen to their business when they can no longer manage it due to incapacity, retirement or death.

Planning Tip: Asset protection planning can and perhaps should be included in many of our clients' estate planning. The time to plan for asset protection is before there is any potential threat. Once the threat of a claim arises, it may be too late.

Planning Tip: For clients who own a business, business succession planning should also be a part of their estate planning. Nobody lives forever, so someday the business will pass out of this owner's control. Planning ahead can provide the time needed to grow and develop the business, groom a successor and look for a potential buyer if desired. If an adult child will take over the business, proper planning can also help provide fairly for any children not involved with the business.

Make Meaningful Charitable Gifts
If a client wants some or all of his/her assets to go to a favorite charitable, religious or educational organization, this must be included in the estate planning. Without a valid will or trust, the assets will be distributed according to state law—and no charity will be among the beneficiaries.

Pass Down Values to Future Generations
For many people, passing along their accumulated intellectual, spiritual, and human wealth to the next generation is just as important as passing along their accumulated financial wealth. Most people take the time to pass along their values and human wealth. Many fail to pass along their financial wealth and plan for their businesses. (More than 90% of family businesses fail to survive to the third generation.) When a parent or grandparent takes the time to plan how to leave assets to family members, it lets them know how much the person cares about them. It is another way to convey values.

If parents have young children, they can select someone who shares their views to manage the inheritance, and they can provide a letter of instruction to the chosen guardian with their views on the care of their children. Grandparents can provide for private or religious education. Even end-of-life and funeral/burial instructions can be personal and convey a client's values. A thoughtful advisor can also help with other ways to pass on a client's accumulated intellectual, spiritual and human wealth, too. Final gifts to a church or synagogue, university, hospital or other favorite cause will let the family know that giving is important to the client.

Conclusion
With the federal estate tax exemption at its highest level, avoiding estate and inheritance taxes is not a concern for many clients. This gives both the professional and the client freedom to plan their estates the way the client wants, without having to jump through hoops to avoid federal estate taxes.

This is also an excellent time to review clients' existing estate plans, especially in light of the changes in the income tax law that went into effect on January 1. Now that we have "permanent" estate and gift tax laws, we have more certainty under which to plan than we

have had in the past 12 years. For clients whose estates are larger, be sure to take advantage of the high exemptions and techniques that are currently available. With the President looking to close more loopholes, many longstanding techniques may not be available much longer.

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