

The background features a hand holding a pen over a document, with the words 'ESTATE PLAN' repeated in a faded font. In the foreground, there is a house-shaped printer with a blue roof and a silver body, with a stack of printed pages emerging from it.

# **Estate Planning 101**

**Wills Vs. Living Trusts**



ESTATE  
PLANNING IOI

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Wills Vs. Living Trusts

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Simply put, estate planning, if done properly, legally permits the management of your assets by people or institutions of your choice when you become unable to manage them for yourself, regardless of the reason. It also allows for the change of ownership of your assets upon death to those people or institutions that you choose. In some cases this can even be done without court intervention.

However, estate planning is actually about much more than what happens to your assets; it's about what happens to you and your family as well. It's not only about planning for what happens after your death, but what happens while you are alive. Asset distribution and control of your finances is a big part of estate planning, but it isn't the only part. There are other important issues covered as well, including:

- ❖ Determining and communicating the medical treatment that you want
- ❖ Assigning a person to enforce medical choices for you
- ❖ Describing funeral arrangements
- ❖ Deciding how your surviving spouse will be provided for after your death
- ❖ Deciding how your surviving children will be provided for after your death
- ❖ Figuring out what will happen to any minor children you may have in the event of an untimely death—this includes deciding on guardianship for the children as well as how they will be provided for financially
- ❖ Assigning who will settle your estate and how it will be settled
- ❖ Planning for your retirement
- ❖ Deciding how the property you own should be held
- ❖ Figuring out whether or not giving your estate away during your life or after your death is the best option for you
- ❖ Minimizing estate taxes

A list like this can sound pretty overwhelming, and, in truth, estate planning can be a complex process. But don't worry. In this report we are going to stick to the basics and walk through them step-by-step.

As we move forward, it's important to keep in mind that estate planning involves more than sitting down once and determining what happens to your money when you die. It's a lifelong process in which you evaluate and re-evaluate your present situation and plan for many aspects of your future as well as the future of your family and loved ones.

Because estate planning involves developing a “plan”, it means that you make decisions about these issues before you get to the point where you are no longer able to do so, either because you lack the ability to make rational decisions, or you've passed away.

Of course, thinking about the future is always a little bit difficult to do. After all, you probably don't have a crystal ball sitting on your desk that tells you what your future holds. When you make plans for the future,

## **What Does “Estate Planning” Mean?:**

### **Defining Your Plan for the Future**

you are always taking a bit of a gamble. You aren't making plans based on an absolutely certain reality, but one that is still in flux and unclear.

For this reason, developing a good estate plan requires that your decisions be based on a wide range of legal, financial, emotional, and logistical concerns. You will want to analyze your current situation as well as your future from all these different angles so you can develop an estate plan that takes into account as many possibilities as you can.

As daunting as this process may sound on the surface, estate planning can be a *very* positive experience. With a little education and the right tools to get you organized, you will find the process to be quite rewarding. After all, it revolves around planning for your future and the future of your loved ones, and what's more gratifying than that?

The first step on the road to planning your estate is learning what your options are. When it comes to estate planning, you have three major options. Let's look at those now.

## **Consider Your Choices: The Three Major Options You Have When it Comes to Estate Planning**

Before you write a will, before you figure out how you want to distribute your assets, and before you make decisions for your minor children, the very first thing you need to know when it comes to estate planning is what your options are.

To put it simply, you have three major options:

1. Do nothing.
2. Write a will.
3. Establish a living trust.

Of course, there are many additional elements to consider when creating an estate plan. And in some cases the options above may overlap. What's more, there is a lot to know about the various types of wills and living trusts and how these may affect you. Not to mention the more complex aspects of estate planning, like dealing with estate taxes.

For now, I want you to understand the basic ramifications of each of the three choices listed above in order to allow you to make a more informed decision about where you want to go with your estate planning from here.

### **Doing Nothing: It May Not Seem Like a Plan, But it Is**

Many people are so bombarded with decisions in their daily lives that when it comes to planning their estate, they feel too overwhelmed to make any decisions at all. They don't write a will or living trust. They don't make decisions about how their assets will be distributed. They don't make plans for being incapacitated physically or mentally. They don't assign guardians for their minor children or plan for them financially. In short, they end up without an estate plan. At least that's what it looks like on the surface.

In actuality "doing nothing" is a plan in itself. It may not seem like a "plan," but it is. I call it "the plan of no plan."

I know it's difficult to face questions like, "Who will I give my assets to upon my death?" and "What will happen to my children should my spouse and I come to an untimely demise?" It's even harder to come up with meaningful answers to these questions.

I also know that planning an estate can seem expensive and time consuming—a daunting challenge that you would rather leave to someone else.

But there is a bigger question lurking in the background, one that many people never address. "What will happen to my estate if I *don't* create an estate plan?" That's the real question that you need to be asking yourself.



Your assets *will* be distributed to someone at your death. Someone *will* have to make decisions for your children if you die young. Medical decisions *will* be made for you if you aren't in a position to make them for yourself. These are undeniable facts.

It may seem as though leaving decisions regarding your estate to someone else is far easier than dealing with it yourself. But before you make that choice, you should have some kind of picture of who is going to make these decisions for you and what the possible ramifications are.

When you die without an estate plan, the distribution of your estate will probably fall under what are called “intestate succession statutes.” These are state laws that determine what happens to someone's estate when they die *intestate*, that is, without an estate plan.

These guidelines attempt to be fair, but they are usually a set of rigid laws that are designed to apply to the broadest possible population. This means that it is unlikely they will address the nuances of your individual situation. And they may have nothing at all to do with your personal desires.

One problem that arises in this situation is that the statutes may not distribute your assets according to your wishes. For example, in some states an estate is divided equally between the surviving spouse and children.

This may seem like a legitimate arrangement, but keep in mind that only a portion of your estate would go to your surviving spouse. If your spouse is older, he or she may end up without enough money to live out his or her life in comfort. Generally speaking, states that have these kinds of laws DO NOT have contingency plans in place for this sort of situation. They simply divide up the estate as the law dictates and that's the end of the story.

All states are different and all state laws are different. The previous example is just one among many different scenarios that I have heard over the years.

Wherever you live and whatever the laws are in your area, one thing holds true when it comes to intestate succession statutes: If you leave your estate planning decisions to these laws, it's very likely that you are *not* going to have an estate plan that fits your personal needs and desires, nor the needs and desires of your surviving family and loved ones.

That doesn't mean that intestate succession statutes are a bad thing. In fact, they are very important for working out situations where no estate plan has been put into place. However, in my opinion, they are not the ideal estate planning tool.

The bottom line is this—doing nothing is your worst plan, but it is still a plan.

## **Writing a Will: The “Traditional” Approach to Estate Planning**

Wills are often called the “traditional” approach to estate planning, because just about everyone knows what a will is and they were considered the centerpiece and primary document in most estate plans until fairly recently. What's more, this is one estate planning tool that most attorneys know something about—even if they don't specialize in estate planning.

Most of you already have an idea of what a will is and what it does. A will is a legally binding document that:

- ❖ Identifies who you are
- ❖ Lists the names of your *beneficiaries* (these are the people or institutions you are giving assets to) with enough identifying information (like names, addresses, and so forth) to make it clear who you are talking about
- ❖ Identifies who your executor will be
- ❖ Defines what will happen to any minor children or other people for whom you are the legal guardian in the event of your death
- ❖ Describes how your assets are to be distributed

A will is a flexible tool that can be changed at any time, as long as you are mentally competent. Statistics show that the average will is changed about four times in a person's life. These changes happen in one of two ways:

1. You can have your attorney write an amendment to your will called a *codicil* (this is just a fancy legal term for amendment).
2. You can have your attorney rewrite the entire will from scratch.

The regularity with which you change your will and the level of changes you choose to make will usually determine which method of change is most appropriate. If massive changes are required, the will may need to be rewritten. If you make minor amendments from time to time, a codicil may be the best approach. Either way, you should speak with your attorney about the best, and most cost-effective, approach to take.

Generally speaking, a will is a less expensive document to prepare than a trust, because wills are less complex. Wills typically cost you between \$200 and \$2,000, but keep in mind that every time you have to change your will, it's going to cost money. What's more, the probate process costs quite a lot, so you don't necessarily save money with a will in the long run.

Which leads me to my next point ...

Wills go through the probate process-- the state's method for legally distributing your estate. There are a few exceptions to this rule, but they are extremely rare. For example, if you have an estate under \$10,000, which very few people do, your will may not go through probate. Or, if *all* of your property is covered by will substitutes, like joint tenancy, beneficiary statements, or payable on death accounts, your estate may not end up in probate. Alternatives like these can create problems of their own, so you really need to consider those choices with your attorney.

This is one of the defining differences between a will and a trust. If it is written correctly, a trust doesn't have to go through probate. A will almost always goes through probate. So it's worth taking a moment to understand some of the major advantages and disadvantages to probate.

### ***Some Advantages and Disadvantages to Probate***

Probably the single biggest disadvantage to probate is that it is almost always lengthy and costly. Probate can take anywhere from a few months to many years and it can cost a lot of money. Everyone has different figures on the average costs of probate. Many people say it can cost upwards of ten percent of your total estate, but I think four to six percent is more realistic.

If that doesn't seem like a lot of money to you, think about what six percent of a \$2 million estate is. That's \$120,000, and it *is* A LOT of money. What's worse, studies have shown that small estates tend to get hit the hardest. Six percent of a \$500,000 estate is \$30,000; and losing 30 grand can be really tough for a surviving spouse or family who hasn't been left a whole lot of money to begin with.

In addition, your survivors will be dealing with a significant time investment if your estate is settled through probate. Being caught up in the courts for months or even years may mean that your surviving spouse, family members, or other loved ones have to relive some aspects of your death for a long time before they can finally settle the matter and move on with their own lives.

That's not to mention the fact that in some cases it is very difficult for survivors to get access to the money in your estate before it has gone through the entire probate process. What does that mean? Well, it could mean that your surviving spouse has to get by on a shoestring budget until probate is complete.

On the other hand, probate offers a specific legal protocol for handling creditors or other entities to which you owe money. When your estate goes through probate, the amount of time these people or organizations have to collect from your estate is limited, meaning your family won't be blindsided by unexpected bills down the road.

These are critical issues for you to take into consideration as you decide what method of estate planning to use. Why? Because if you decide to write a will, your estate will almost surely go through probate, and your survivors will have to deal with all of the advantages and disadvantages of that system.

There is more to know about the advantages and disadvantages of probate, and I encourage you to talk about this in more detail with an estate planning attorney. For now, here is a summary of some of the advantages and disadvantages of this estate planning option:

### ***Advantages of a Will***

- ❖ Distribution can be settled through the probate court, which may protect your estate to some degree.
- ❖ The probate process can reduce the time allowed for creditors to make claims against your estate.
- ❖ A will is traditionally cheaper to prepare than a trust (approximately \$200–\$2,000).

### ***Disadvantages of a Will***

- ❖ Your estate files can be accessed through the records office.
- ❖ Probate can take anywhere from a few months to several years.
- ❖ Probate may need to be held in each state, if you own property in more than one state.
- ❖ Probate and legal fees can become very expensive.

## **Establishing a Living Trust: A New Tool for Estate Planning**

If some refer to a will as the “traditional” approach to estate planning, you might think of a living trust as the “new” or “modern” approach. In reality, from an historical perspective, this designation is quite unfair. The first documented trusts date back to the Roman Empire, so trusts are far from “new.”

A *living trust*, also known as a *revocable trust* or a *family trust*, is a legal entity that owns your assets yet allows you to remain in complete control of those assets. Living trusts are also sometimes referred to as “revocable trusts” or “family trusts.” The terms “living” and “revocable” refer to the fact that the trust can be changed, or “revoked”, as long as you are alive and competent.

There are two critical ideas in this definition for living trust. They are:

1. The trust is a separate legal entity that owns your assets.
2. The trust is “living” and can be changed any time you are alive and competent.

Let’s go over each of these points in detail to help you develop a deeper understanding of how the living trust works.

### ***The Living Trust as a Separate Legal Entity***

Living trusts are a bit like corporations in one sense: When you create a living trust, you are creating a separate legal entity, the same way that you do when you create a corporation. Though this “entity” doesn’t have a physical existence, from a legal standpoint, it is still an individual entity.

On some level, this just sounds like a technicality right? Why should you care that a trust is a “separate legal entity”? Isn’t that just a bunch of legal mumbo jumbo?

Well, not exactly. When it comes to estate planning, the fact that a living trust is a separate legal entity has important ramifications that may impact the choices you make. Here’s why...

Due to the fact that a trust is a separate legal entity, it can own assets just the way you do. In fact, to make your living trust fully functional, you will want to turn ownership of your assets over to your trust. This process is called *funding* your trust.

On the surface, this sounds a bit scary ... even dangerous. Why would you want to relinquish ownership of your assets? Wouldn’t that make it much easier for someone else to take advantage of your assets or take control of them entirely?

I hear concerns like this from many people. However, the fear that you will lose control of your assets using a living trust is unfounded.

***You can remain in complete control of your assets when they are in a trust.***

As long as the documentation that creates your trust is formulated correctly, and you assign yourself as trustor and trustee of the trust, there is absolutely *no* danger that you will lose control of your assets. With a living trust, you retain all of the incidents of ownership, both good and bad. This means that you can buy, sell, borrow on, transfer, and manage these assets any way you want.

Not only do you retain all of the incidents of ownership, but basically you continue to operate as you always have financially. You can still spend and save the way you normally would. You can acquire additional assets. You can sell off others. You even continue filing the same tax paperwork. Your financial life is essentially unaltered for as long as you are alive and competent.

After you pass away, however, living trusts affect many things about the protection and distribution of your estate.

First of all, living trusts may help you avoid probate. The reason? When you die, you don't own your assets; a different entity owns them—namely, your trust.

Avoiding the probate process could save your heirs A LOT of time and money. This is one of the major advantages of a living trust. It allows you to pass your assets on to your heirs without having to deal with probate.

This is why it's so important that your trust is "a separate legal entity." That status gives the trust the right to independently own your assets. Remember, probate only applies to assets that *you* own. It does not apply to the assets your trust owns.

Perhaps more importantly, when you create a separate legal entity that owns your assets, you put yourself in a position to take advantage of estate planning options that are not available to you with a will. You gain access to a level of flexibility in your estate plan when you use this "living" document that usually isn't available to you with a will.

### ***The Flexibility of a Living Trust***

As I stated earlier, trusts are called "living" or "revocable," because you can readily change them as long as you are alive and competent. This can be very advantageous when it comes to estate planning. When you are planning for the future, you are planning based on a set of events that are essentially unknown. As time passes, your wishes may change. Being able to change your estate plan so that it continues to reflect your wishes over time is very attractive for some people.

This, in conjunction with the wide variety of living trusts available, offers you a measure of flexibility that you don't have with a will.

You can leave your assets to whomever you wish, you can distribute them as you like, you can retain a large measure of control over them after you die if you choose, and you can change your plan at any point in time.

As you might imagine, this flexibility comes with a price. The initial expense of creating a living trust tends to be a bit more than writing a will. At the time of this writing, trusts typically run around \$2,500.

But it's possible that trusts will help you save money over the long run. You have the opportunity to avoid probate fees with a living trust and there are often additional tax protections that come with trusts as well. (We will discuss some of these later in this report.)

You should know about living trusts if you are going to make knowledgeable estate planning choices. You may or may not choose to use a living trust in the long run, but you really shouldn't be ignorant about this area of estate planning.

What I have provided above is a very basic overview of the living trust. Today there are *many* different kinds of living trusts available. You should speak with your attorney about options that fit your specific situation. The information provided will give you some of the grounding that you need to have such a discussion.

The main thing to understand, for now, is that a trust is a dynamic and sophisticated alternative to a will, more and more people are opting to use it these days, and it offers extraordinary flexibility when planning your estate.

Of course the living trust has advantages and disadvantages of its own like everything else does. Here are a few of the major ones:

### ***Advantages of Living Trusts***

- ❖ A trust can turn over your assets to your heirs while avoiding the probate process, thus avoiding the time and expense that usually occurs with probate.
- ❖ Unlike a will, a trust is a private document and is generally not in the public record.
- ❖ A trust can provide uninterrupted management of your estate should you and your spouse become incapacitated.
- ❖ A living trust is valid in every state.

### ***Disadvantages of Living Trusts***

- ❖ The initial cost of a living trust is usually more than a simple will.
- ❖ A little more time and effort is required to produce a living trust.
- ❖ You have to fund the trust, which is a separate process from creating the trust, and that takes some time in and of itself.
- ❖ A trust does not provide a limited time frame for creditors to collect on your estate the way a will that goes through the probate process does.

To review, let me reiterate what your three major choices are when it comes to estate planning:

1. You can do nothing. This is your worst plan, but it is still a plan.
2. You can write a will.
3. You can create a living trust.

In actuality, there are really only two choices here: Either you choose to create an estate plan, or you choose not to. That's what this all comes down to.

If you've read this far, my guess is that you want to create an estate plan. Great! You've made a good choice. I firmly believe ***everyone*** has an estate to plan for.

Whether you choose a will, a living trust, or both (for many, this is the best plan--see the section on "Pour Over Wills" below for details), there are a handful of key documents that will likely go into your estate plan, and you should understand what these are and what they are designed to do. Let's take a few more moments to review these documents now.

## The Pour Over Will: What it is and Why it's Important

**W**hen people develop trusts, they often develop pour over wills to go along with them. Sometimes people leave certain assets out of their trusts. Usually this happens inadvertently, often because people don't understand how to fund their trusts properly.

The pour over will is a contingency plan that states that any items accidentally left out of a trust are to "pour over" into the trust upon the death of the trustee.

Keep in mind, anything left outside your trust will go through probate. That means that pour over wills have to be processed through probate, despite the fact that the will states that the assets are to pour over into your trust.

Nonetheless, they are a good thing to have just in case you leave something out.

## More than Wills and Trusts: Five Major Elements that Go Into a Quality Estate Plan

Estate planning goes beyond the distribution of your assets, it's a method of planning for your future and the future of your family. An estate plan gives you an opportunity to put in place legal measures that will help protect and execute your personal desires and choices regarding your future—both while you are alive and after you have passed away.

A comprehensive estate plan takes into account many of the possible outcomes your future may hold and sets up a strategy for dealing with these possibilities. This includes everything from what will happen to any minor children you may have in the event of a premature death, to who will make medical decisions for you in the event that you are no longer able to make them for yourself.

Of course, estate planning isn't a system for governing every single aspect of your future. However, if you plan your estate properly and include all of the documentation that you need to create a comprehensive estate plan, you *can* plan for many issues surrounding your death or potential incapacity.

To cover as many of these issues as possible, most quality estate plans consist of five major elements. Let's take some time to look at each of them so you can start thinking about how they may fit into your plan.

### ***Paperwork that Describes How Your Assets will be Distributed and Who is to Distribute Them***

Typically, the centerpiece of your estate plan is the paperwork that describes how your assets will be distributed and who will be the executor or successor trustee distributing those assets. This means a will, a trust, or both. We discussed each of these briefly above. As important as these documents are, they are only one part of your estate plan. There are other important elements to consider as well.

### ***Paperwork that Determines Guardianship for Any Minor Children***

If you are a parent with children under the age of 18, the next part of your estate plan that should be considered is what will happen to your children in the event of your untimely death. For parents, this element of the plan may even be more important than the paperwork that defines how your assets will be distributed. After all, it has to do with the welfare of your kids.

There is something that I want to make crystal clear: if you don't get around to creating an estate plan, if you choose to do nothing, or if you decide not to appoint a guardian for your child, the court *will* appoint one

for you. State laws govern who obtains guardianship of your minor children. In many cases, surviving family members' wishes and advice are taken into consideration; in others they are not. It all depends on the situation.

I feel confident in saying that this is not a decision you want to leave in the hands of the courts. Frankly, it's not a decision the court wants to make either. If you do leave this decision in the hands of the law, you are taking a *huge* risk. The courts may identify an excellent guardian for your child, or they may not. You don't have to gamble your children's future this way if you create an estate plan.

The courts will not only appoint a guardian for your child if you fail to do so, but they will also make decisions regarding financial distribution to this guardian so he or she can finance the rearing of your child. In this case, there will be A LOT of oversight from the state in terms of how the money is managed. This can be a good thing or bad thing, depending on the situation. Either way, you should be aware of the facts.

You have the right to appoint guardians for your children in the event that you die before they are of an adult age, and you can define those choices whether you choose to go with a will, a trust, or both.

The main difference between using a will or a trust in this regard revolves around the amount of control you choose to have over how assets will be distributed to care for your minor children. Both tools are equally effective in terms of defining guardianship; however, they are different when it comes to the distribution of assets.

Before describing how they are different, you should be aware, up front, that, unless you make special legal arrangements (which you can talk about with your attorney), minors cannot formally own property of any kind. Even when special arrangements are made, courts generally require oversight to be maintained over the child's property.

This means that outright distributions made to a child are effectively managed by the child's guardian, not the child. When this happens, the guardian has a great deal of control over how the assets are used. Again, depending on the situation, this can be a good thing or a bad thing.

With a will alone, you generally have less control over how your assets are distributed unless you include a testamentary trust. That means unless you include a testamentary trust in your will, your control over the money ends once the distribution is made. It also means that no one else will be watching how your money is used. The responsibility for managing the money and raising your children will be the sole responsibility of the guardian you choose.

With a trust, on the other hand, there are *many* options for distributing wealth to your children. You can make the guardians of your children responsible for their money, or you can choose another trustee entirely if you choose to. For example, if you want your children to be raised by your compassionate, loving sister who has always cared for your children as her own, but you know she isn't very good with money, you can appoint her guardian and appoint someone else, or an independent institution like a bank for that matter, to manage the financial future of your children.

In fact, the options you have with a trust are almost endless. Here are a few other examples:

- ❖ You can create provisions that specifically determine how the money is used. For example, you could set aside a certain amount for education, a certain amount for buying a house, and a certain amount for your child's wedding if you choose to.
- ❖ You can defer distribution until your child reaches a certain age, or you can give them the money slowly over time by setting up a series of distributions that will occur at certain ages.
- ❖ You can make investments for your children and protect them in the trust.
- ❖ You can assign a successor trustee to manage the trust and grow your wealth even after you have passed away, so your children have greater financial stability.
- ❖ You can set up a trust so that your children and their guardians can live off of the interest of your trust while keeping the primary assets safe within the trust.

Of course, the financial component of this issue isn't nearly as important as determining who you want to act as guardian in your stead. With an estate plan you get to do both: identify a guardian and plan for your children's future. If you are a parent, this is a very serious consideration and I strongly encourage you to start making these decisions sooner than later.

### ***Durable Power of Attorney for Finances***

A power of attorney is a legal instrument which grants another person (or people) the right to make binding legal decisions on your behalf in the event that you are no longer able to do so yourself.

Usually, when planning an estate you have two powers of attorney executed: the "durable power of attorney for finances" (also referred to as "the general power of attorney"), which I will describe in this section and the "power of attorney for medical care", which I will describe in the next section.

A durable power of attorney for finances allows you to determine who will make financial decisions for you in the event that you are living but are no longer capable of making such decisions yourself. The person (or people) you assign is called your "attorney in fact", which is just a legal term that means they are authorized to make certain decisions for you under the power of attorney paperwork.

If you are in a coma or have dementia, for example, and some financial decision needs to be made about your estate, your attorney in fact would have the power to do this.

You can make your attorney in fact the same person as your executor or successor trustee, but that doesn't necessarily have to be the case. You can assign several people who have to work in conjunction with one another if you wish to, though this isn't always advisable. You can even set limitations regarding the amount of power your attorney in fact has, though this may not always be advisable either.

Giving someone power over your finances while you are still alive can be scary, but the reality is that it's usually a lot better to plan for a durable power of attorney for finances in advance while you are still able to choose who you want to fulfill this role, than to wait until the state steps in and assigns someone.

The main thing to think about when you appoint this position is simple: You want to choose someone who will make legitimate decisions on your behalf in terms of your finances. That means that you should choose someone who is responsible, financially savvy, and understands what your desires are.

It is a very good idea to sit down and talk with the person you choose, so he or she has as much information about your desires as possible. This will give your attorney in fact the power to make good decisions in case you are incapable of doing so yourself.

### ***Durable Power of Attorney for Medical Care***

The other power of attorney that you should consider executing is the durable power of attorney for medical care.

Your durable power of attorney for medical care names the person who will make medical decisions for you in the event that you aren't capable of doing so yourself. This person is also referred to as an "attorney in fact". The position is analogous to the power of attorney for finances, except that it revolves around your medical care and personal well being.

As with the attorney in fact for finances, the person that you choose to be your attorney in fact for medical care could be your executor or successor trustee, but doesn't have to be. It doesn't have to be the same person as your attorney in fact for finances either. These roles could overlap, but they don't have to. You can choose anyone you wish to be your attorney in fact for medical care. Also keep in mind that you can assign limitations on the power that your attorney in fact for medical care has.

You want to keep similar things in mind when you choose your attorney in fact for medical care as you do when you choose your attorney in fact for finances. The person should be reasonably responsible, should

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<sup>1</sup>There is a slight variation to this arrangement which is only for individuals dying in 2010, and is beyond the scope of this discussion.



understand what you would expect in the medical care setting, and you should be confident in his or her ability to make decisions on your behalf.

### ***The Living Will***

The final element of an estate plan that I want to discuss in this section is the living will. A *living will* is not a will in the typical sense. It doesn't have anything to do with how your assets are distributed. Instead, it addresses another very important issue: it makes your wishes regarding the use of life support explicit so the hospital knows whether or not they should keep you on life support indefinitely, or take you off, even if it will lead to your death.

The miracles of modern medicine are not to be discredited. They have improved the human condition in countless ways. However, they do have their potential downside. In today's world people can, in some cases, be kept alive on life support almost indefinitely. And for some, this is not the preferable option.

Your living will establishes what has recently become known as “your right to die”—that is, your right to be taken off of life support and be allowed to pass away in the event that your chances of recovery are minimal.

While it may not be comfortable to think about yourself hooked up to a life support machine right now, making a decision about what you would prefer in this situation can take a big burden off of your family. It is very difficult for the family to have to make a decision to “pull the plug” when they don't know what your wishes are. Making your family decide whether you live or die can be incredibly traumatic for them.

There was some controversy in the past about the legality of a living will. However, today most states recognize the living will and a person's right to die.

You may wish to be kept on life support indefinitely in the hopes that medicine will make a breakthrough that can save you, or, you may not. The choice is yours. The critical point is that you make the choice and you make your wishes explicit and legally executable by putting in place the correct documentation. A living will allows you to document your right to die.

Remember, before you appoint anyone to operate in the capacities described above, you should ask them if they are willing to take on the responsibility. Sit down and have a discussion with them about what the position entails. Don't surprise anyone at your death or in the event that you are incapacitated with your appointments in these areas. You don't want to assign a guardian for your child or an attorney in fact before discussing the matter with them.

Don't be offended if someone you ask turns down your request. Some people may not feel equipped to take on these responsibilities. That's their choice. Take their response as a sign of respect. After all, if they are honest enough to say no, it probably means that they are a good friend. You can find someone else to fulfill the task for you.

I encourage you to begin considering what your choices will be in each of the 5 areas outlined above as soon as possible. You don't have to make any decisions immediately, but I suggest that you begin narrowing down the possibilities and focusing in on the people you want to serve in these roles sooner than later. It can take a big burden off your family and will be a relief to you in the long run to make decisions about who will be the key operators in your estate plan.

Before I close this report, there is one more major topic I want to discuss: estate taxes. This is an area many people have questions about, so let's review some basics now.

### **Estate Taxes: How to Keep Uncle Sam out of Your Pocket**

One of the primary factors that comes into play when people plan their estate is taxes. People want to learn how to properly plan their estate so they can reduce their tax burden and save as much as possible for the beneficiaries.

And well they should! When you don't plan properly, estate taxes can substantially reduce the size of your estate.

However, legal measures have been put into place that can help you protect your wealth, if you know how to take advantage of them. When you die, Uncle Sam is going to come along and take his fair share. But you may be able to minimize the amount the government gets with knowledge and proper planning.

Tax law is complex. All of it is. And there are few areas of tax law as complex as estate tax law. What's more, Congress perpetually changes the laws making it very difficult for the average person to keep up with what's going on.

Whole volumes have been written on estate taxes. I am not going to try and give you a complete overview of all the ins and outs of these extremely complicated laws here. And, in reality, you don't need to have all the gory details to make sound estate planning decisions.

In this report, I will give you a basic understanding of how estate tax law works so that you can begin to take these concepts into consideration as you plan your estate. However, your decisions in this area should ultimately be made in conjunction with your attorney.

Having said that, there are two things I want to encourage you to do before we even get started with a discussion about estate taxes:

1. Try to keep up with the changes in estate tax law so you can make sure your estate plan is in line with the laws as they change. This will allow you to make changes to your estate plan as necessary, so it always reflects your wishes.
2. Discuss *any* questions you have with your attorney and CPA. He or she should be able to help you get them answered.

As long as you do that (and read the information in this section), you should be able to safely navigate your way through the world of estate taxes.

There are 5 major types of taxes that can affect your estate. They are:

1. Federal Estate Taxes
2. State Inheritance Taxes
3. Gift Taxes
4. The Generation Skipping Tax
5. Capital Gains Taxes on Assets Inherited then Sold

In this report we will do a brief overview of the first two areas--federal estate taxes and state inheritance taxes--as these are the kinds of taxes that typically impact an estate most significantly. However, I encourage you to discuss all five types of taxes above in detail with your attorney so you can make credible decisions in each area.

Keep in mind as you read the sections that follow that I *am not* encouraging you to withhold payment of estate taxes. That is not a good idea, and it's not something I would encourage. I simply want you to have the information you need so you can make intelligent decisions about your estate.

### ***Federal Estate Taxes: How Uncle Sam Gets His Share***

Federal estate taxes are currently only paid on estates that are fairly large to begin with. At the writing of this report, no estate is taxed that isn't worth at least \$5 million. With good planning you can often protect an estate that is double that size, and with excellent planning you may save even more money in some cases.

Understand that federal estate tax laws change *all* the time, and this is largely based on the fact that so many different people have different opinions regarding estate taxes. The only thing you can be relatively certain of is that these taxes will continue to be under debate and will continue to change as the years pass.

It's pretty unlikely that estate taxes will disappear forever. They are an excellent source of income for the federal government, and we all know the federal government isn't always the best at managing money. It always

needs a bit more, and estate tax is a fairly easy way to get it. So it's very probable that *some* estate taxes will continue to be part of the IRS's grand plan.

What's more, it's likely your federal estate taxes will be the largest tax bill your estate carries. So you need to know the basics of how federal estate taxes work.

The tax code that governs gift taxes and estate taxes is called the Unified Gift and Estate Tax Code. They are bound up in the same code for a variety of reasons. However, it all basically comes down to this: the IRS looks at giving gifts and giving away your estate to beneficiaries as essentially the same thing as far as taxation is concerned. One is done during your life (giving gifts), the other is done after your death (giving away your estate), but you are essentially doing the same thing—turning over your assets to someone else.

Federal estate tax basics are actually pretty straightforward. Everyone is allowed one *federal estate tax exemption*. This is the total value of one person's estate that is exempt from taxation. At the time this report was written, the exemption is \$5 million. That means you are only taxed on the portion of your estate that exceeds \$5 million. If your total estate is valued at less than \$5 million you don't pay any taxes at all.

If you are married (and with a bit of planning) you can take advantage of *two* federal estate tax exemptions—yours and your spouse's. This is called the Maximum Marital Deduction and totals \$10 million at the time of this writing. This law protects the rights of married couples who share assets by offering them the same rights they would have if they were single. However, if you aren't careful, you can lose one of these exemptions.

The amount that is exempt changes regularly, as you will see in the chart below. So make sure you regularly check what your exemptions are.

On your death your estate will be valued by your executor or successor trustee. If the total value of your estate exceeds the value of your exemptions, you will most likely pay taxes. Generally you will pay taxes on any amount above your total exemptions. The equation for what you will pay taxes on is very simple:

$$(\text{The total value of your estate}) - (\text{Your total exemptions}) = \text{Your taxable estate.}$$

So if you are married, have a \$12 million estate, and die in 2012, you would pay taxes on \$2 million. If you are single, have a \$6 million estate, and die in 2012, you would be taxed on \$1 million. The basic math is quite simple, though the equation becomes more complex as other factors come into play.

Estate tax rates are usually very high. Let's have a look at exactly how high, so you have an idea for what you are in for. Table 4-1 below is the tax table for the years 2004–2013. It gives tax rates as well as exemption rates for these years.

<b>FOR DECEDENTS DYING DURING</b>	<b>TOP ESTATE TAX RATE</b>	<b>FEDERAL ESTATE TAX EXEMPTION</b>
2004	48%	\$1,500,000
2005	47%	\$1,500,000
2006	46%	\$2,000,000
2007	45%	\$2,000,000
2008	45%	\$2,000,000
2009	45%	\$3,500,000
2010	REPEALED	N/A
2011	35%	\$5,000,000
2012	35%	\$5,000,000
2013	55%	\$1,000,000

Table 4-1: Estate Tax Rates and Federal Exemption Amounts

From the table above it's easy to see how heavy these taxes are. They average inside the 50<sup>th</sup> percentile, and that means **half** of your estate in excess of the federal estate tax exemption could be paid to the taxman.

You may not think the taxes above apply to you. Perhaps you don't think you have a \$5 million estate. Maybe you don't. But I strongly encourage you not to underestimate the value of your estate and think you are safe from taxes. If you do, you are less likely to put plans in place that can save money for your beneficiaries. It's always best to plan for the worst-case-scenario (which in this case is actually the rather enjoyable idea that you will have substantial wealth to share with your family). So put plans into place that will protect your money from a potentially heavy tax burden.

More to the point, estate tax law changes regularly, as I stated above. If you take a look at the table, in 2013 the federal estate tax exemption is currently scheduled to drop to \$1 million, if the law isn't changed. Many people have estates of this size. So please take this area of tax planning seriously. Take the time to protect your wealth for your beneficiaries.

The next tax I want to discuss is state inheritance taxes.

### ***State Inheritance Tax: The State Wants its Share Too***

State estate taxes are commonly referred to as "inheritance taxes." This is to distinguish them from federal estate taxes and because the term "state estate taxes" is just plain confusing. So if your attorney or accountant talks about "estate taxes" and "inheritance taxes" as two separate entities, you'll know why.

The laws on inheritance tax vary a *great* deal from state to state. There aren't even meaningful average rates that I can share here, because the laws are so different for every state. In fact, some states' tax rates change depending on who you leave your assets to. For example, assets left to your children may be taxed at a different rate than assets left to your grandchildren. These may be taxed at a different rate again from assets left to brothers, sisters, nieces, nephews, or friends.

You should also be aware that the annual exemption rates in your state may not be the same as the annual federal exemption rate. This can affect your planning choices in *significant* ways.

The key is to discuss this matter with your attorney and your accountant. They should be knowledgeable regarding the inheritance laws in your state, so they should be able to help you. You should know specifically how inheritance taxes work in the state you live in so you can make effective choices regarding your estate plan.

What I *can* tell you is that inheritance taxes are usually determined in one of three ways:

1. They are included as part of your federal estate taxes and your state simply tags on its rates to what you owe the feds. This means you only file your federal taxes, and everything gets paid off at once.
2. They are evaluated separately from your federal estate taxes, in which case you have to file separate paperwork with the state and pay two separate bills.
3. They may not apply at all in the state you reside in.

Whatever the case, you will need to know the laws in your state and the tax rates that apply and you will need to work this information into your estate plan with the help of your attorney.

Another thing to keep in mind is that you may owe inheritance taxes in more than one state. If you own property in more than one state, you will need to pay inheritance taxes in each of those states. Again, different laws apply in different states, so you will need to discuss all of this with your attorney as you create your estate plan.

## **Where to Go From Here: The Next Steps in Estate Planning**

I hope you have enjoyed this overview of estate planning basics. Though it may sound strange, developing an estate plan is an extremely fulfilling undertaking. Putting plans in place that protect you and your loved ones now and in the future is not only worthwhile, but it is one of the more enjoyable legal activities you can work through. If you are considering developing an estate plan of your own, I applaud your decision.

The next step is to locate and work with a top-quality estate planning attorney. I invite you to give my office a call so we can discuss how we can help you outline your desires, explain what you've learned about estate planning so far, and investigate each of the areas outlined in the report in detail.

I wish you luck on your journey to protect your wealth and your family for years to come.