

# Concepts in Estate Planning

## *A Simplified Explanation*

**Aufman Associates Inc.**

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Estate planning is essential for successful individuals and families... and the planning focus can evolve based on the stage of life.

For young families, it is about who will care for their children. For couples, it is about providing for the survivor. And for older folks, estate planning is about the best way to pass assets to adult children and later generations. Charitable desires often play a role as well.

Two factors dominate the process: 1) passing the assets the way you want and 2) minimizing tax and cost.

### **Will vs. Direct Beneficiary**

A will is an important first step in any estate plan. Without one, an estate's distribution will be dictated by state law, with no consideration given to the deceased's wishes. Assets that pass via the terms of a will are addressed in court and are termed "probate assets."

The probate process begins with the appointment of the executor, who is responsible for carrying out the terms of the will. An inventory of assets is later filed with the court and this becomes public information.

While a will is essential, assets are often transferred outside the will. We refer to these assets as "direct beneficiary assets."

Any asset that flows outside the will is a direct beneficiary asset. One example is an IRA, which will flow to the named beneficiaries directly; the terms of the will are irrelevant.

Other examples include most joint accounts, life insurance, transfer-on-death (TOD) accounts, and most other retirement accounts.

Because direct beneficiary assets pass outside the will, the probate process is avoided. However, if one of these assets lacks a proper beneficiary, it would be paid to the estate and become a probate asset.

### **Revocable Trust**

Just about anything that is not a direct beneficiary asset can be put into a revocable trust. Aside from the will, a revocable trust is the most-common document.

This is a trust that is completely accessible to the grantor during his or her lifetime. Assets can be moved into and out of the trust for any reason. By being in trust, the assets avoid the probate process. The trust will pass to beneficiaries according to the terms of the trust.

Aside from some cost savings, estates that avoid probate can often be settled more quickly. This is especially true in states that tend to have very slow probate courts, such as Florida or Arizona.

All in all, it is sensible to make beneficiary elections when possible, and to use a revocable trust for other assets, all to minimize the assets subject to probate. But this is not always possible.

A revocable trust is not always necessary and the simplicity of a single document (will) is sometimes the best solution.

### **Other Strategies**

Instead of the will or revocable trust passing assets outright to beneficiaries, many clients favor an ongoing trust. In this case the will directs the formation of a trust or the revocable trust directs how the trust will operate after the passing of the grantor.

Passing assets to trust provides control and some potential estate tax savings for future generations.

Large estates often consider a legacy trust, which keeps the assets in trust for multiple generations, or indefinitely.

### **Additional Standard Documents**

When reviewing and updating an estate plan, the attorney will typically draft powers of attorney, which allow an individual to act on your behalf. It is also common to draft a healthcare directive, which can provide specific instructions regarding the types of medical treatment you want to receive.

### **Fiduciary Roles in an Estate**

An executor (male) or executrix (female) is responsible for carrying out the terms of the will. This role is temporary and the job is finished when the estate closes.

A trustee oversees the assets in a trust and follows the terms of the trust. This role can be more important because it continues as long as the trust is in force (or until a successor takes over).

### **Taxes and Expenses**

An estate may be subject to different taxes and expenses.

Federal estate tax currently applies to estates with assets over \$5.43 Million; the tax rate is a flat 40%. Married couples have a total of \$10.86 Million and the surviving spouse can “inherit” any amount of the first spouse’s \$5.43 Million exemption that is not used at his/her death. This is called “portability,” and a timely federal estate tax return must be filed to take advantage of it, whether or not any tax is due.

When federal estate tax is projected, more sophisticated estate planning strategies should be considered. These strategies often include irrevocable life insurance trusts, qualified personal

residence trusts, and family limited partnerships. There are many other solutions as well.

There is an unlimited marital exemption (federal and state), so no estate or inheritance tax is due on assets passing to the surviving spouse. Any potential tax would be deferred until the death of the survivor.

Twenty states have some form of estate or inheritance tax, the majority of which exempt estates of less than \$1 million. Pennsylvania, however, has no exemption but does have a low 4.5% tax rate on assets that pass to children, grandchildren, and siblings. Ohio and Florida, in contrast, are among the majority that does not tax estates.

Legal fees can vary. In the “old days,” attorneys often charged a percentage of the total estate. This is now uncommon, and does not neatly align with the amount of legal work necessary. Attorneys now typically charge by the hour, and the legal fees are usually reasonable for an average estate.

The strategies, taxes and expenses discussed in this summary apply to U.S. citizens. Different planning is typically required for non-U.S. individuals that have a connection to the U.S.

### **Conclusion**

Estate planning is complex and can take many forms. We look forward to our continued review of your circumstances.

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This review was prepared by Edward B. Aufman, CFP and William J. Gaffey, CFA.

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