Basic Estate Planning For Non-Estate Planning Lawyers Coffee Table Talk

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What you need to know for yourself, your relatives, and to cross-sell estate planning to your clients…

Estate Planning

You can lead a horse to water, but you can't make them drink. It's tough to talk someone into estate planning. It has to be something that someone wants to do because it's human nature to think that it's not going to happen to you.

Wills

1. Avoid intestacy: Everyone needs a Will to avoid the state controlling your decisions.

2. Pourover assets: You even need a Will if you have a revocable trust and are funding the Trust to avoid probate - just in case something gets left out, or the heirs need to appoint a Personal Representative to file a lawsuit.

3. Guardian: Persons with minor children need a Will to name a guardian of their children. Preferably, a couple agrees on the guardian.

4. Avoid home-made Wills – We get a lot of business from probating wills that were not properly prepared or executed (then it requires a formal probate). The list of problems is endless. This is not an area to dabble in. We don't recommend obtaining a form from a colleague and attempting to duplicate the form for your own situation. It may work, but if it doesn't work, then fixing the problem is more expensive than doing it right the first time.

Probate

1. Definition: Probate is the filing of a Will with the local court where decedent died in order to appoint a personal representative to have the powers and rights to handle decedent's property and rights.

2. Avoidance: Many people try to avoid probate by funding a revocable living trust. It is often a result of participating in probating a parent's estate. There are other ways to avoid probate in Arizona: (i) use a small estate affidavit if the total value of real property (reduced by encumbrances) is less than $100,000 and personal property is less than $75,000; (ii) ensure all property passes by TOD designation (transfer on death for bank accounts), beneficiary designation (including real property by beneficiary deed) and operation of law (JTWROS), then still have small estate affidavit procedure for small items, if necessary.

3. Probate is not that difficult or expensive in Arizona (unlike e.g., California, Ohio, and Florida). If an asset gets left out, survivors will still have to open a probate. The idea is to avoid probate in more than one state. If you own real property in more than one state, you need to create a trust and transfer the property to the trust to avoid probate in the state where you just own the real property.

Powers of Attorney

1. Health Care Powers of Attorney (HCPOA): The agent names an attorney-in-fact to make health care decisions when agent is unable to do so. In Arizona, also includes a Living Will (pull-the plug document).

2. Durable Powers of Attorney (DPOA): The agent names an attorney-in-fact to make financial decisions (write checks, pay bills) when agent is unable to do so.

3. Simple documents: Everyone who is over 18 should have one (including your college-age kids) before it is too late to sign one.

4. Avoid guardianship/conservatorship proceedings: HCPOAs and DPOAs may be used to avoid an expensive guardianship or conservatorship proceeding which often can cost $10,000 in Arizona.

5. Effectiveness: Not valid after death.

Trusts

1. Living Trusts: the most common trusts are revocable during lifetime.

2. Why do you need a trust: It used to be that you needed one to preserve a spouse's estate tax exemption. A Trust is no longer required for that purpose because of portability, but you may still want one for other reasons: privacy (will is public record), avoiding probate, especially in other states, asset protection or estate tax protection for beneficiaries, effective use of generation skipping transfer exemption, and/or preservation of assets for children after second marriage.

3. Irrevocable Trusts: These types of trusts are used to make lifetime gifts to children to remove assets from estate for estate tax purposes and sometimes to obtain the advantage of leverage when the gift into the trust is small but the ultimate value upon your death is large (like life insurance).

4. Lots of other types of trusts for different purposes, usually when the donor can afford to make gifts without affecting their lifestyle: GRITS, GRATS, IDGTS, SLATS, ILITS, CLATS, CRATS, CRUTS, QPRTS, QDOTS, QTIPS, and so on…. (No time to explain) Just say that estate planners like acronyms.

Estate Tax, Generation Skipping Tax and Gift Tax

1. Estate tax exemption is $5,430,000 for 2015 ($5,450,000 in 2016) per person, $10,860,000 for 2015 ($10,900,000 in 2016) per couple with portability or traditional trust planning (AB trust structure) – For example, if all of the property that you own upon your death is less than $5,430,000 (reduced by any gifts made over the annual exclusion amount during your lifetime), then your estate will not have to file an estate tax return and will not owe estate tax. If your estate is over that amount (an estate tax return needs to be filed), you may receive a marital deduction for gifts made to your spouse, but that property will be includable in her estate for estate tax purposes. However, she can obtain your unused estate tax exemption to exempt her estate from estate taxes, or your estate tax exemption was protected in your trust agreement.

2. Property in your estate includes life insurance, qualified plans, business interests, bank accounts, brokerage accounts, real property, and tangible property, including cars, jewelry, collectibles, cash or gold under the bed.

3. Estate tax is 40% of any amount of property over the exemption. GST Tax is also 40% on any distribution to a skip person that is not protected under the GST rules or by allocation of GST Exemption.

4. Generation skipping transfer tax exemption is the same amount as estate tax exemption. If transferring wealth to skip persons, which include grandchildren, in trust or otherwise, you may need to protect from GST Tax using GST exemption. Portability does not work to transfer GST Exemption.

5. Gift tax exemption – You can gift up to the amount of your estate tax exemption during life without paying taxes, but then on your death, there will be a 40% tax on any remaining property in your estate.

6. Annual exclusion – Each year, each person can gift up to $14,000 per person, so a couple can gift $28,000 to each child. Any gifts over this amount to any person may be subject to the use of your exemption and a gift tax return should be filed.

For higher net worth clients, who may owe an estate tax either on the death of the first spouse or on the death of the second, or for a single person, such person should plan on how their estate taxes are going to be paid. Do they have enough liquidity in their estate to pay the estate taxes? If not, maybe they should consider life insurance, whether it is a second to die policy or a policy on their own life.

What is trending and what you can say to your clients to sound savvy…

1. Generally: Since the estate tax exemption for one person is so high ($5,430,000) this year and does not affect as many people, rather than estate tax planning, the current issues are portability (described below), asset protection and income tax planning. One issue related to income tax planning that clients don't think about that is extremely important is the beneficiary designation for their qualified plans, which may be a significant portion of their estate.

2. Portability: Many married clients are simplifying their estate plans to avoid an extra income tax return after the death of the first person, to allow for flexibility and to get a step-up in basis of assets on the death of each person using portability of the applicable exclusion amount between spouses. Portability was made permanent in the American Tax Relief Act of January 1, 2013. There are pros and cons to using portability and is not always a one size fits all answer.

3. Beneficiary Designations: If you have a large 401(k) or IRA account (which most professionals like yourselves do), we recommend reviewing your beneficiary designations to determine if they are correct to obtain best tax advantages. Should always name a spouse first, unless it is a second marriage and you want to protect the principal of the IRA for your children.

   We have created conduit (flow-through) trusts in our trust documents so that an IRA that is payable to a child will be paid to their trust and they will not receive the payout of their entire share but they will receive the required minimum distribution ("RMD") (e.g. $4,000,000 IRA, two children, spouse predeceases, children are 18 and 21, you may not want your children to be able to withdraw $2,000,000 from their share of the IRA accounts after your death, which may happen if not held in trust).

   DANGER: If the beneficiary designation is to a revocable trust that does not have special provisions in it, then the IRA may have to be paid out and fully taxed in its entirety within five years.

4. Income Tax Protection: Income tax rates are higher than ever. Even if you have created a trust for your children after your death, depending on the circumstances, you may want to allow them the opportunity to pay taxes at their income tax rate using various mechanisms, instead of at the trust rates. It's a trade off because now the property is includable in their estate for estate tax purposes (but is still creditor protected under Arizona law) but their trust pays lower income taxes. This mechanism can be implemented by a Trust Protector so the child has options.

5. Asset Protection Planning for spouse and children: Create a subtrust on your death that holds specific property in trust for spouse or child with specific distribution provisions. As an example, we can include a provision that requires the child to have a qualifying marital agreement (prenuptial or postnuptial agreement) with their spouse before they can obtain any assets from the trust for purposes of protection of the property on divorce.

6. Business Succession Planning: Many of your clients own businesses with partners. Do they have a succession plan in place? Upon the death of the partner, do they want to be in business with the spouse of the partner, or even worse, the children of the partners?

7. GST Issues: One of the most common issues that keeps reappearing in larger estates is improperly drafted irrevocable trusts that will have a GST Tax in certain circumstances (e.g., child outlives parent but predeceases distribution of entire trust). There are many different ways to deal with this issue. Have an experienced estate planning attorney review the irrevocable trusts.

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