

Estate Planning - What You Need to Know



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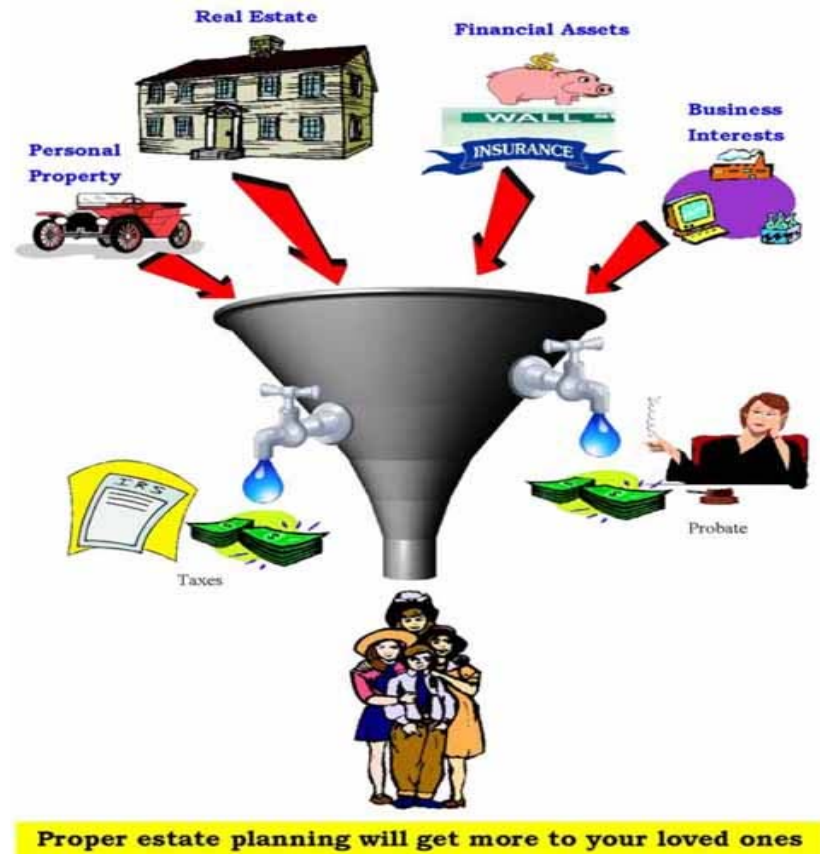
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Who needs estate planning?

- ▶ No matter your net worth, it's important to have a basic estate plan in place



Goals of Estate Planning

- ▶ Provide for you during the remainder of your life
- ▶ Provide for support and security of your spouse
- ▶ Provide for support and security of your children
- ▶ Provide a guardian for your minor children
- ▶ Educate your children and grandchildren
- ▶ Protect family business
- ▶ Assure that assets are distributed according to your wishes
- ▶ Make final charitable gifts
- ▶ Minimize estate taxes
- ▶ Minimize or avoid probate expenses after death
- ▶ Protect your assets from creditors

Basic Steps in Estate Planning

- ▶ Choose a qualified team (Lawyer, CPA, Financial Advisor, Insurance Agent)
- ▶ Organize your information and determine goals
- ▶ Meet with the team to discuss strategy and address your planning objectives
- ▶ Prepare a plan then implement it
- ▶ Maintain the plan
- ▶ Review the plan periodically
 - ▶ Marriage, Divorce, Death of spouse, Disability, Health status, Retirement
 - ▶ Birth, Adoption, Education, Special Needs
 - ▶ Moving to another state
 - ▶ Inheritance, Gift, Moving to another state, Acquiring property in another state

Basic Estate Planning Documents

- ▶ Financial Power of Attorney
- ▶ Directive to Physicians and Family or Surrogates (aka Living Will)
- ▶ Medical Power of Attorney with HIPAA Authorization
- ▶ Declaration of Guardian
- ▶ Will



Overview of Wills & the Probate System

- ▶ Will allows you to select an executor
 - ▶ If Will names executor, then the probate process is simple:
 - ▶ Will is filed at the courthouse following the decedent's death
 - ▶ After a waiting period of 10 days, a short probate hearing is held. After brief testimony, the court admits the Will to probate and officially confirms the appointment of the executor.
 - ▶ Court issues "Letters Testamentary" to the Executor
- ▶ Will gives instructions on how to transfer your assets to heirs
- ▶ Will allows you to designate the guardian for any minor children

Executor Responsibilities

- ▶ Prepare an Inventory, Appraisal, and List of Claims
 - ▶ Due 90 days after executor is appointed but can be extended for 6 months
 - ▶ Does not have to be filed in the probate proceeding and made public record if all debts have been paid (except for secured debts, taxes, and administration expenses)
 - ▶ If not required to file, then the executor files an affidavit stating a copy has been given to all beneficiaries
- ▶ File Notice to Creditors
- ▶ Manage estate assets during administration
- ▶ Pay any estate obligations including estate taxes
- ▶ File income tax returns for the estate
- ▶ Distribute estate assets in accordance with the terms of the will

Types of Assets

- ▶ **Probate Assets** - Subject to estate administration and pass to beneficiaries according to the terms of the will.
- ▶ **Non-Probate Assets** - Pass to beneficiaries via other contracts, such as beneficiary designations, rights of survivorship, pay on death directives, etc.



Non-Probate Assets

- ▶ Joint accounts with right of survivorship
- ▶ Ownership with POD (“Payable on Death”) instructions
- ▶ Retirement plans listing beneficiary
- ▶ Annuity contracts listing beneficiary
- ▶ Life insurance listing beneficiary
- ▶ Assets in trust

Very important to review your accounts and policies to make sure they are set up the way you intended.

Texas is a community property state. Community property rules should be considered when planning transfers of non-probate assets

Overview of Estate & Gift Taxation Systems

- ▶ Estate and Gift taxation is a “Transfer” tax system
- ▶ Taxed on the right to transfer property by gift or at death
- ▶ Estate and gift tax is currently unified under one rate schedule
- ▶ 2015 exemption is \$5,430,000 and indexed for inflation
- ▶ Top estate tax rate is 40%
- ▶ Because the current estate exemption is so high a lot of estate planning now focuses on income tax planning



Tax Basis

- ▶ Assets received by gift = Carryover basis (except for property sold at a loss)
- ▶ Assets received by inheritance = Step-up (step-down) to FMV at date of death
- ▶ Texas is a community property state. Basis in both halves of the property are adjusted to FMV at date of death.



Portability of Unused Exemption

- ▶ Allows the unused exemption of the deceased spouse to be transferred to the surviving spouse (i.e., the unused exemption is “portable”)
- ▶ Surviving spouse adds the amount received to the surviving spouse’s lifetime exemption
- ▶ Surviving spouse can use the amount for gifting during life or transfers at death
- ▶ Effective for deaths on or after January 1, 2011
- ▶ Election must be made on a timely filed estate tax return for the deceased spouse (even though you are not otherwise required to file)
- ▶ Surviving spouse can only use the most recently deceased spouse’s unused exemption. This may become an issue if the surviving spouse remarries.

Example of Portability

- ▶ Husband dies in 2015 with \$3M taxable estate (assume \$5M exemption)
- ▶ Form 706 Estate Tax Return filed for husband to elect portability
- ▶ Wife now has \$7M exemption for transfers she makes during her lifetime or at death

Husband

\$5 mil

Dies with
\$3M assets

Estate

Exemption \$5 mil

Used 3 mil

Unused \$2 mil

Wife

\$5 mil

+ 2 mil

\$7 mil

Portability
of \$2M

Estate Planning Tools

- ▶ Unlimited marital deduction
- ▶ Gifting
- ▶ 529 Plans
- ▶ Life Estates
- ▶ Living Trusts
- ▶ Testamentary Trusts

Unlimited Marital Deduction

- ▶ Can transfer an unlimited amount of property to your spouse without using any of your lifetime exemption
- ▶ Outright transfer or in trust
- ▶ Property left to your spouse is included in your spouse's estate



Gifting

- ▶ \$14,000 annual exclusion for 2015
- ▶ Carryover tax basis
- ▶ Amount given in excess of annual exclusion reduces your lifetime exemption

Example with No Marital Deduction

- ▶ Husband dies in 2015 with \$8M of assets (assume \$5M exemption & 40% tax rate)
- ▶ Husband leaves all assets to his children

Husband Total Assets	\$8,000,000
Marital Deduction	<u>0</u>
Total Estate	\$8,000,000
Exemption	<u>(5,000,000)</u>
Taxable Estate	\$3,000,000
Tax Rate	<u>x 40%</u>
Tax Due	\$1,200,000
Net Estate to Beneficiaries	\$6,800,000

Example with Marital Deduction

- ▶ Husband dies in 2015 with \$8M of assets (assume \$5M exemption & 40% tax rate)
- ▶ \$3M of assets are left to wife
- ▶ Wife has \$2M of her own assets

Husband's Assets	\$8,000,000	Wife's Assets	\$2,000,000
Marital Deduction	<u>(3,000,000)</u>	Inherited from H	<u>3,000,000</u>
Total Estate	\$5,000,000	Total Estate	\$5,000,000
Exemption	<u>(5,000,000)</u>	Exemption	<u>(5,000,000)</u>
Taxable Estate	0	Taxable Estate	0
Tax Rate	x 40%	Tax Rate	40%
Tax Due	<u>0</u>	Tax Due	<u>0</u>

Net Estate to Beneficiaries of Both Estates \$10,000,000



529 Plans

- ▶ Also known as Qualified Tuition Programs
- ▶ Used to save for future higher education expenses of a designated beneficiary
- ▶ Earnings grow tax free
- ▶ Distributions are exempt if used for higher education expenses including tuition, fees, books, and room and board
- ▶ Not part of the donor's gross estate
- ▶ Can use 5 years' worth of annual gift exclusion to gift to a 529 plan
- ▶ Can transfer unused amounts to other qualified members of the beneficiary's family

Life Estates

- ▶ Divides the ownership of property into
 - ▶ Life tenant
 - ▶ Remaindermen
- ▶ Allows the life tenant to retain the income and use of the property for his or her life with the remaindermen receiving full ownership of the property when the life tenant dies
- ▶ Creates a non-probate asset
- ▶ Life tenant continues to pay the utilities, taxes, insurance, repairs, etc.
- ▶ Selling or mortgaging the property may be complicated
- ▶ Remaindermen have an interest in the property and if sued or owe taxes their liens could be filed against the property, the property could be part of their divorce settlement, etc.

Trusts

- ▶ Not an “entity”
- ▶ Better described as a “relationship” between three parties -
 - ▶ Grantor - establishes the trust and funds it with assets
 - ▶ Trustee - manages the trust assets for the benefit of the beneficiaries; has a “fiduciary duty” to the beneficiaries
 - ▶ Beneficiaries - the people and/or institutions who benefit from the trust
 - ▶ Current income beneficiaries
 - ▶ Remainder beneficiaries

Reasons to Use Trusts

- ▶ Control your wealth - You set the terms of the trust that control when and to whom distributions are made. Prevents ownership of assets from being diluted by division among future generations.
- ▶ Asset Protection - Trusts can help protect your estate from your heirs' creditors or from beneficiaries with poor money management skills or unstable relationships.
- ▶ Provide for minor beneficiaries or beneficiaries with special needs
- ▶ Pass assets to charitable organizations
- ▶ Potentially avoid probate

“Living Trusts”

- ▶ A type of *inter vivos* trust
- ▶ Can be revocable or irrevocable
- ▶ Grantor transfers assets into trust during lifetime
- ▶ Grantor can be trustee
- ▶ Property passes to beneficiaries pursuant to the terms of the trust agreement (non-probate)
- ▶ Avoids probate for property in trust
- ▶ Important to change title of assets to trust’s name
- ▶ Execute a “Pour-Over” Will

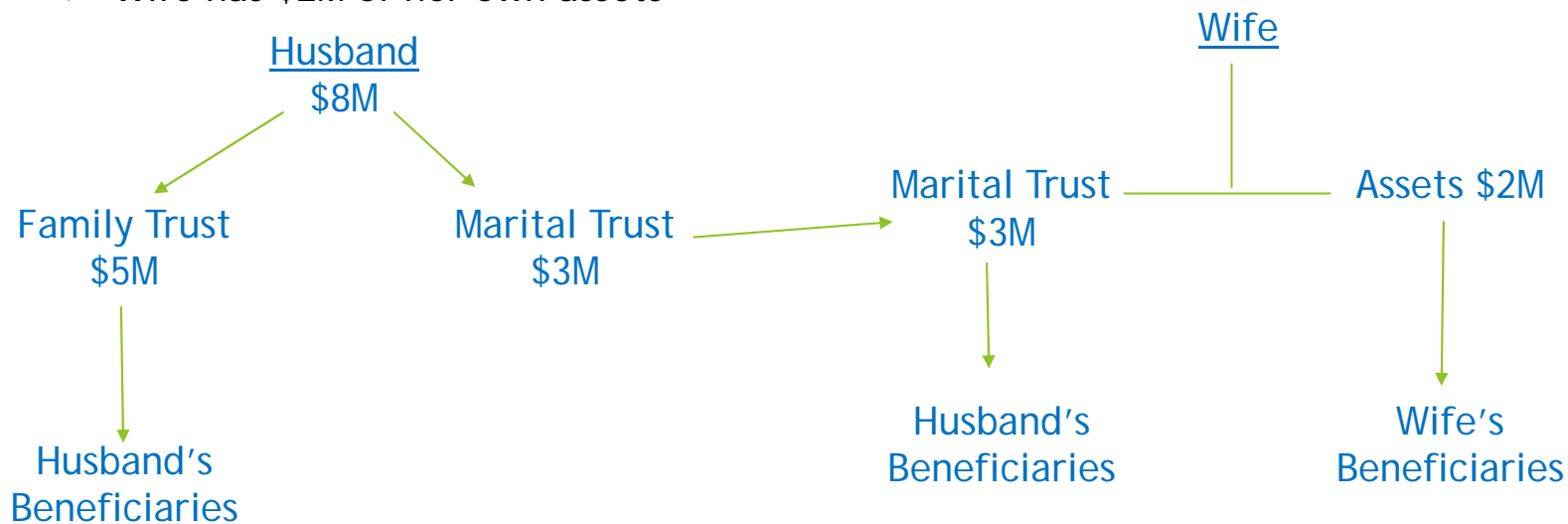
Testamentary Trusts

- ▶ Established at death by terms of a Will
- ▶ Common Types
 - ▶ Marital Trust - Allows you to provide lifetime support for your spouse without leaving assets directly to your spouse. Property going into a marital trust can qualify for the marital deduction but allows you to direct who receives the property at your spouse's death. Assets are included in your spouse's estate.
 - ▶ Bypass (Family) Trust - Often created to use the decedent's lifetime exemption
 - ▶ Trust for Children - Can hold assets for your children until they reach a certain age. Great planning for children with marital problems or creditor problems.



Example of Testamentary Trust Planning

- Husband dies in 2015 with \$8M of assets (assume \$5M exemption)
- \$3M of assets are left to Marital Trust & \$5M are left to Family Trust
- Wife has \$2M of her own assets



- Husband uses \$5M exemption to fund Family Trust and marital deduction to fund Marital Trust. No tax due at Husband's death.
- Wife has Marital Trust for her benefit. At her death Marital Trust is included in her estate. Total estate is \$5M, so no tax due.
- Family Trust may also benefit wife but also has other beneficiaries.
- Husband names beneficiaries of both trusts. Wife names beneficiaries of her \$2M.
- Great planning for second marriage or children from prior relationships.

Estate Planning Mistakes

- ▶ Dying intestate (without a Will)
- ▶ No disability documents
- ▶ Improper use of WROS and POD when establishing ownership of checking accounts, brokerage accounts, CDs, etc.
- ▶ Adding a person's name to an account and unintentionally making them an owner
- ▶ Dying with out-of-state real estate in deceased person's name
- ▶ Leaving estate outright to children who have marital problems or creditor problems, instead of using trusts.



Questions?



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