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Estate planning

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What to do before you die

Overview of estate settlement and probate

The estate settlement process takes the capital you've built during your lifetime and distributes it to the people you want to enjoy it. The way your assets are distributed affects how and when others receive their share of your estate.

There are four general ways your property could be distributed when you die: through **probate**, through **ownership designations**, through **contractual payments** and with a **trust**.

Probate

The property you own alone is distributed through probate. Probate is a court-supervised process in which your personal representative — or executor — gathers all your property, pays outstanding debts and claims, and distributes the remaining assets.

Who receives the leftover property? That depends on whether or not you have a valid will. If you do not have a will, your state's intestacy laws determine who gets your property and when they receive it.

The major drawback to intestacy is that the estate's distribution plan will probably not direct your property to those you want to receive it. Intestacy can be described as "one size fits all." Because you cannot mold the state laws to meet your needs, intestacy has some significant disadvantages:

- Your property is typically divided between your spouse and children; your spouse will not receive all your assets.
- Your children are entitled to their share of your estate when they reach the age of majority. Upon reaching this age, no one can control their money even though they may not have the financial ability to handle it properly.
- You lose the opportunity to choose your representative and your children's guardian.
- You lose the opportunity to save taxes and minimize costs.

What is a will?

The basics of wills: Ensuring your wishes are carried out

A last will and testament is an essential estate planning tool.

Planning ahead can help avoid the problems inherent in your state's intestacy laws. A will lets you design a distribution plan tailor-made to your needs. You control who gets your property and when they receive it. You can name your personal representative and guardian and use strategies to reduce taxes and costs.

Probate has several disadvantages, however.

- In some cases, probate is slow. In a complex estate, it can take years.
- Probate can be expensive. Administration and probate costs can range from 4 to 5 percent for large estates or more for small estates.

You can avoid probate in three ways: through specific property ownership such as jointly owned property, through a contractual arrangement like life insurance that is paid to a named beneficiary and through a trust such as a revocable living trust.

Ownership designations

Assets you own with another may be titled as joint tenancy with right of survivorship. This means that upon the death of either of you, the survivor becomes the sole owner of the property through this right of survivorship. These assets never enter the probate process.

Joint tenancy is an effective way to avoid the costs and delays of probate. However, most legal experts agree it is not a substitute for a will. Because joint tenancy does not reduce taxes, it may not make sense for all your property, and since it does not name a personal representative, you still need a will to provide a complete estate plan.

Contractual payments

Some of your assets will pass to your family by contract and are not subject to probate. A life insurance death benefit is an example of an asset that passes in this way. Annuities, IRAs, 401(k)s, SEPs and SIMPLEs also avoid probate when you name a beneficiary other than your estate. This method of distribution has three advantages:

- It avoids the delay and expense of probate.
- It is not subject to a will challenge.
- It ensures privacy because, unlike probate, it is not a matter of public record.

On the other hand, if federal estate taxes are a concern, you may need to review these beneficiary arrangements and update them.

Terms to know

Beneficiary: A beneficiary is a person or entity legally designated to receive the benefits from your insurance and financial products.

Estate planning: Estate planning is a process that determines how your money and other property should be managed during your life and after your death. Wills and life insurance are components of the process.

Executor: The person who administers a person's estate upon their death. Often referred to as a personal representative, their primary duty is to carry out the deceased person's wishes based on instructions spelled out in their will or trust documents.

Irrevocable trust: Any trust where the grantor cannot change or end the trust after its creation. Grantors may choose a trust with such limitations to limit estate taxes or to shield assets from creditors.

Retirement solutions: Financial strategies of saving, investments and ultimately distributing money meant to sustain oneself during retirement.

Revocable trust: A trust that can be changed or revoked by the grantor after it is set up. That means the grantor retains control of the assets. In a revocable trust, any income generated is taxable to the grantor, who pays taxes on distributions and any capital gains.

Trustee: The organization or person who administers the trust.

SEP: Simplified Employee Pension

SIMPLE: A SIMPLE IRA plan (Savings Incentive Match PLan for Employees) allows employees and employers to contribute to traditional IRAs set up for employees.

Trusts

You can also control your property's distribution by creating trusts that manage your assets and distribute them at times you designate. A separate legal entity, a trust is created by a legal document — the trust agreement — drafted by an attorney and signed by you. When assets are titled in the name of the trust, the trustee, named by you, will have the authorization to manage those assets and, consequently, implement your wishes as dictated by the trust. At a specific time or upon the happening of an event, the trustee distributes the assets to the beneficiaries you have named in the agreement.

Trusts are created for a variety of reasons: to save income and estate taxes, to avoid probate, to provide professional management of assets, and to delay the distribution of assets until the beneficiaries can effectively manage the assets themselves. The trustee must handle the property in accordance with your directions, as spelled out in the trust agreement, and must use their best judgment to protect the beneficiary's interests.

A trust can be created while you're alive or even at your death through your will. There are a variety of trusts available to meet your needs. Some trusts can't be changed once they've been created. Others can be changed while you are still alive — a popular trust today used by many to avoid probate is the revocable living trust.

At your death, such trusts become fixed and their assets are removed from the probate process. This way, you can retain privacy and efficiently finalize your affairs.

Minimizing death taxes

The federal estate tax is levied on property transferred at death. For many people, this is the most significant expense of dying. In recent years, changes in federal estate tax laws have allowed many Americans to avoid this tax if they plan correctly. The law allows each person to transfer a certain amount of property — the "exemption amount" — estate tax-free at death and gift tax-free during life. The federal estate tax has another tax-saving feature: you do not have to pay federal estate tax on property left to your spouse. This so-called "marital deduction" allows you to postpone the estate tax until your spouse's death. The remaining assets over the exemption amount will be taxed at that time. You can save a great deal on taxes if you take advantage of these two tax breaks. Many states also have state death taxes. Talk to your attorney and financial professional to determine whether these estate taxes apply to you.

What a personal representative does

Your personal representative — alternately referred to as the executor of your estate — will collect and protect your assets, pay the debts of your estate, and distribute what's left to your heirs. This sounds simple, but the entire process can entail several separate steps. The first thing your personal representative must do is locate and read your will. To make it easier for them, feel free to download and use this handy **document locator worksheet**. Next, your personal representative will take your will to the Probate Court and attempt to prove the will valid.

Your personal representative's most challenging duties will involve collecting and preserving your assets. This is another good reason to download and use our handy **document locator worksheet**. Your personal representative will take title of all bank accounts and securities in the name of your estate. They will also have to set up a checking account and record system. All money due your estate must be collected. This includes making insurance claims, filing claims for veteran and Social Security benefits, and similar items. Responsible for protecting your assets, your personal representative must obtain adequate insurance coverage and maintain your property.

Your personal representative must also pay off all estate debts. Your creditors will have three to 12 months to make their claims depending on your state's law. A federal estate tax will be payable if your estate is large enough. Many states also have an inheritance or state death tax. The expenses of probating and administering your estate must also be paid. Your personal representative will also have to file income tax returns for both you and your estate.

All of this will cost money. It may be necessary to liquidate estate assets to pay for all these items. After all the debts have been paid, your personal representative will distribute whatever remains and make a final accounting to the court. At this point, if everything is in order, your personal representative will be discharged. Since probate can be long, complex and demanding, you should carefully consider their qualifications before naming a qualified personal representative.

Choosing a personal representative

First, decide whether to use a corporate personal representative or an individual. A corporate personal representative is familiar with the probate process, can handle the many complexities of the probate process properly and has perpetual existence. That is, unlike an individual, it won't get sick; it won't die; it won't be on vacation when a death occurs. If an individual personal representative dies or becomes seriously ill during probate, the process could be seriously disrupted. Finally, don't forget that a personal representative can be held liable to the heirs for mistakes. It may be inadvisable to subject your family members to liability.

But before naming a corporate personal representative, be sure the trust company or bank is willing to administer your estate. For example, some trust departments will not administer an estate unless it exceeds a certain size. In addition, your will might contain a provision that a particular corporate trustee would not be willing to administer, such as retaining a family business during the probate process. Also, check out the corporate personal representative's fee structure and investment track record. Finally, determine how sensitive the trust company will be to your family's needs.

Despite the many advantages of choosing a corporate personal representative, many people still name family members as personal representatives. Some people feel that a family member may be more sensitive to the needs of the family than a corporate trustee and family members often serve without compensation. A family member will likely have to hire an attorney to handle the probate process, so the actual savings may be less than expected. Before naming a family member as your personal representative, ask yourself:

- Is the family member in good health?
- Is the family member responsible?
- Does the family member have sufficient time to handle estate affairs?
- Will other family members be offended that they were not named?

Sometimes attorneys and accountants are named as personal representatives. To avoid misunderstandings, decide beforehand whether they will receive compensation for being both the personal representative and being the attorney or accountant for the estate.

Planning for business interests

If you have an interest in a sole proprietorship, partnership, limited liability company, or closely held corporation, you have an immediate need for estate planning. Your business interest is probably the largest, most important asset you own. If you want your family to continue the business, three conditions should be met.

1. There must be someone with experience who can profitably run the business.
2. Your family must be able to get a steady income from the business.
3. Your surviving partners and employees must be willing to cooperate with your family.

If even one of these three conditions can't be met, your family may be better off with cash instead of the business. Unfortunately, they may have difficulty getting a fair price if they decide to sell after you're gone. The business may not be as valuable without you. In addition, potential buyers may know your family has to sell; thus, they may offer less than the business' actual worth. Planning while you are alive is the best way to meet these requirements. If you are concerned about treating your children equally, planning can help you accomplish this objective even though one or more of them is not active in the business.

If you think your family will be better off without the business, planning during your lifetime can help them get the most out of it. A buy-sell agreement, which you can make during your lifetime with a key employee, your business partners, or outsiders, is the best way to guarantee your family gets a fair price for what you've worked so hard to build. Such an agreement establishes the price and terms on which your business interest could be sold at your death or retirement. Your attorney can help you structure such an agreement that best meets your needs.

Flexibility

Estate plans must be flexible. Your plan should carry out your wishes for the property you own today. As time passes, however, your personal circumstances and objectives will probably change, and you may have different needs than when your plans were first drafted. Your children will grow up and have children of their own. State and federal laws affecting your estate plan may change. You may move to another state that has different laws. Thus, you must regularly review your estate plan and update it to keep pace with changing needs and laws. Talk to your attorney and financial professional regularly to ensure your estate plan is up to date.

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