Estate Planning Basics

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Estate planning is just a fancy term for arranging what happens to your property after your death. It also includes planning for your financial affairs in the event you become incapacitated. That's why everyone needs a basic estate plan. Here's how to start your plan:

- ***Calculate your net worth.*** For starters, organize all your financial files to take account of everything you own and everything you owe. Getting organized will also give your family easy access to important records when they need them.

Once your files are in order, create a net worth statement by subtracting your liabilities from your assets. Entering your information into a personal finance software program helps you keep your calculations up-to-date.

- ***Prepare for the possibility of incapacity.*** Review your disability income insurance to determine if you're adequately covered. Then create or update three essential documents.

A *durable power of attorney for finances* allows you to designate someone you trust to manage your financial affairs. A *durable power of attorney for health care* allows you to appoint someone to make decisions about your medical treatment. And a *living will* spells out your wishes regarding the use of life-sustaining procedures.

Next, consider your possible long-term care needs. Neither Medicare nor Medigap pay for most long-term care, and to qualify for Medicaid you have to spend down most of your financial resources. Long-term care insurance, which covers nursing home care and some home care, may be an option. Whether you're a candidate for coverage depends on your age, income, current health status, and overall estate planning objectives.

- ***Review your life insurance needs.*** In addition to providing essential support to your survivors, life insurance proceeds are not subject to income tax. A policy's proceeds, however, are generally subject to estate taxes.

Also consider your special needs for life insurance. For instance, if you have significant assets, a life insurance policy can provide cash to pay any estate taxes owed so your heirs won't be forced to sell valuable illiquid assets.

- ***Write or update your will.*** If you die without a will, your assets will be distributed according to state law, not necessarily according to your wishes. In fact, if you're married and have children, it's not safe to assume everything will go to your spouse. That's because in many states your assets are divided among your spouse and your children, even if your children are minors, with restrictions on how the children's share can be spent.

Even worse: A court could end up choosing a guardian for your children. Furthermore, if you die with an outdated will, your intended heirs may be left out in the cold.

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✔ ***Check your designated beneficiaries and how your assets are held.*** Review your designated beneficiaries on your investments, retirement plans, annuities, and life insurance policies to make sure they reflect your current wishes. This task is especially important since the designations on these documents supercede your will instructions.

Also review the title registrations on all your assets to ensure they meet your current needs, and also to ensure that your property will be passed to your heirs in the most tax-efficient manner.

✔ ***Take steps around probate.*** If appropriate to your situation, you can transfer some of your assets directly to your heirs and avoid probate costs and delays by simply filling out a few forms.

For savings and money market deposit accounts, checking accounts, CDs/share certificates, and Treasury securities, complete a *payable-on-death* form. For stocks, bonds, and mutual funds outside retirement accounts, if allowed in your state, complete a *transfer-on-death* form.

✔ ***Consider whether trusts should be part of your estate plan.*** Consult an estate planning professional about whether any of the different types of trusts may be appropriate for you.

Trusts can help you take care of your surviving loved ones, as well as allow you to exercise some control over how your assets are used after your death. Trusts can also help you avoid probate, make charitable gifts, or help manage your affairs if you become disabled. In addition, if you have substantial assets, setting up certain types of trusts can help reduce estate taxes.

You're entitled to pass up to the exemption amount, $1.5 million in 2004, to your heirs free of federal estate tax. And if you're married, the unlimited marital deduction generally allows you to leave any amount to your spouse free of federal estate tax.

If you have a substantial estate, however, leaving everything outright to your spouse may not be the best tax strategy. Here's why: If you leave everything directly to your spouse, no federal estate tax is levied at the time of your death because of the unlimited marital deduction. But when your spouse dies, any remaining assets from your estate have become part of your spouse's estate, and only your spouse's exemption amount is left to offset estate taxes – your exemption amount is no longer available.

So if your spouse's taxable estate exceeds the exemption amount applicable in that year, the estate tax will be imposed.

One way to prevent this is to set up what's called a credit shelter trust, or bypass trust, to keep your assets out of your spouse's estate, and to pass the maximum amount allowed to your future heirs free of federal estate tax.

In 2004 the estate tax is assessed only on those who die leaving a taxable estate of more than $1.5 million. This exemption amount will keep rising in steps until it hits $2 million in 2006, and $3.5 million in 2009.

The Tax Act of 2001 fully repeals the estate tax in 2010. More accurately, however, the law repeals the estate tax only for that one year. Due to budgetary restrictions, the 2001 estate tax rules, rates, and exemptions will come back in force in 2011 – unless future legislation is enacted before then.

✔ ***Get the facts on the gift tax rules.*** If you have significant assets, giving away assets during your lifetime can also help reduce your taxable estate. In general, in 2004 you can give up to $11,000 worth of assets a year per person to any number of people without incurring federal gift tax.

If you're married, you and your spouse can give a total of $22,000 free of gift tax to any number of people each year. You can also give an unlimited amount free of gift tax to qualified charities, as well as directly to educational institutions for tuition, or directly to medical services providers for medical care. In addition, the marital deduction generally allows you to give an unlimited amount to your spouse free of gift tax.

In 2004 through 2010 you can make a total of $1 million of taxable gifts before owing any federal gift tax.

For more information about estate planning, please contact me.

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