

# Estate Planning Defined

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## What Is Estate Planning?

Estate planning, a rather complicated process, has a straight-forward definition. In short, estate planning is arranging for the orderly transfer of your assets (property) following death. The ideal estate plan minimizes taxes, expenses, and delays and assures that your assets reach intended heirs.

Some mistakenly believe that an “estate plan” is a single document with a standardized format drawn up by an attorney. It’s not. It is an individualized plan based on your unique situations and circumstances. And, although it is recommended to use the assistance of professionals for certain parts of an estate plan, much of the actual process can be done by the individual developing the plan. Other common misconceptions are that estate plans are only for the wealthy or those in their latter years of life. Wrong again. Who can define “wealthy” and who can predict when their last year of life will occur?

The bottom line is – if you own property, you need an estate plan. Some are quite simple – others quite complex. No two are just alike, but all require some or all of the following actions:

- Inventory property to determine what you own and what you owe.
- Understand how your property is owned.
- Name beneficiaries.
- Identify strategies to avoid probate or to reduce the amount of property that must pass through probate court.

- Prepare a will.
- Use trusts, if necessary.
- Evaluate insurance policies.
- Identify strategies to minimize taxes and expenses associated with the distribution of your estate.
- Select professionals to assist with the development of an estate plan.
- Review and update your plan as the need arises.
- Plan for the expenses of your funeral and burial or other form of body disposition.
- Plan for liquidity of assets to pay debts.

These actions ensure that property will go to those you select in an orderly and economical fashion and, most importantly, will ease the administrative burden placed on your survivors, who are already trying to deal with the emotional trauma of death.

## What Is an Estate?

An estate includes all property (real and personal) a person owns minus any debts. In planning for the distribution of an estate, it is important to distinguish between a **gross estate**, a **taxable estate** and a **probate estate**. Their definitions follow:

**Gross estate** – The total value of all property and belongings including such things as jointly owned property, pension benefits, IRAs, pay on death accounts, etc. The value of a gross estate also includes life insurance death benefits paid on policies owned by

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the deceased, certain property transferred during one's lifetime in which an interest was retained, and in some instances, property transferred within three years of death.

**Probate estate** – Property and assets distributed under the direction of a probate court. Jointly owned property and/or assets for which a beneficiary has been designated (life insurance, pension, IRAs, pay on death or transfer on death designations, etc.) are not part of the probate estate.

**Taxable estate** – The gross estate, minus all debts, taxes, probate court costs, costs associated with estate administration (i.e., attorney, accountant, appraiser and executor fees) and minus the deductions for transfers to the spouse and charity.

Because two goals of estate planning are to 1) minimize taxes and 2) avoid costly and lengthy probate proceedings, understanding these terms is important.

## How to Estimate a Gross Estate, Probate Estate and Taxable Estate

***Scenario:** Joe and Ann, husband and wife, would like to estimate the value of their estate. They have no children or grandchildren. The following steps can be used to complete the chart found on page 3.*

### Gross Estate

Joe's and Ann's first step is to list their property and identify current beneficiaries, if applicable. (Refer to column 1 of the chart on page 3.)

The second step is to identify the legal owner of the property. This is shown in column 2 of the chart on page 3. When property is owned jointly, the form of joint ownership should be designated.

Next, determine the fair market value of the property. Fair market value is generally defined as the price at which property would change hands between a willing buyer and a willing seller. Typically, fair market value of real estate and certain personal property is determined by appraisal. Valuing other assets, such as investments and insurance, may require the help of a broker, agent or accountant.

Completing columns 4 and 5 depends upon property ownership. If property is owned jointly, the market value will be divided and shown under the gross estate of both Joe and Ann. If the property is owned solely, the market value will be inserted in the column directly under the owner's name. By referring to the chart, you can see that Joe's gross estate totals \$110,000 and Ann's \$360,000.

Note how life insurance is valued for the gross estates. Since Ann owns the Universal Life (UL) policy that insures Joe's life, the value of the policy would be included in her gross estate should she predecease Joe. The value to be included in Ann's gross estate is determined by adding the cash surrender value of the policy and any unearned premiums. Contact your insurance company for exact figures.

Joe owns the term insurance policy; therefore, the \$50,000 face value is part of his gross estate.

### Probate Estate

Property not jointly owned with right of survivorship or without a beneficiary designation is subject to probate. Joe and Ann own their house jointly with survivorship rights as tenants by the entirety. Neither partner can sell the home without the other's signature.

Joe and Ann own Individual Retirement Accounts (IRAs) with beneficiary designations, two life insurance policies on Joe's life with Ann as beneficiary, a bank account and treasury note, both with Payable on Death (POD) designations. Therefore, none of these assets are subject to probate. In fact, Joe does not have a probate estate.

The land parcels Ann owns as a tenant in common with her sister and as a sole owner are, however, subject to probate. Ann's probate estate is estimated at \$250,000.

### Taxable Estate

To determine Joe's and Ann's taxable estates, their gross estates must first be reduced by all of their debts, taxes due at death, funeral and burial expenses, charitable bequests and other miscellaneous costs associated with settling the estate.

Because Joe and Ann are husband and wife, the estate of the first partner to die will not be subject to estate taxes under the Marital Deduction Rule. This rule says that spouses may transfer property of unlimited value to each other without incurring gift or estate tax liability.

Even if Joe and Ann were not married, their estates would not be subject to estate taxes. Estate taxes are not required if the net value of a **taxable estate** is less than \$5,000,000. This amount is reduced, however, if during your lifetime, you made gifts worth more than \$13,000 per person per year.

Persons whose taxable estates are close to or exceed the amounts in the preceding paragraph should consult a tax attorney. They can acquaint you with legal tools that can be used to reduce or avoid estate taxes.

## Estimating a Gross Estate and Probate Estate

Property	Legal Owner	Market Value	Gross Estate		Probate Estate	
			Market Value			
			Joe	Ann	Joe	Ann
<b>HOUSE</b>	Joe and Ann (Tenants by the Entirety)	\$50,000	\$25,000	\$25,000	0	0
<b>LIFE INSURANCE</b> Joe's Life	Joe	\$50,000	\$50,000		0	0
1) Term Policy Ann is beneficiary						
2) Universal Life Policy Ann is beneficiary	Ann	\$100,000 (Face Value) \$20,000 (Market Value)		\$20,000 (Estimated Value) <sup>a</sup>	0	0
<b>RETIREMENT</b>						
1) Joe's 401(k) Ann is beneficiary	Joe	\$25,000	\$25,000		0	0
2) Ann's IRA Joe is beneficiary	Ann	\$50,000		\$50,000	0	0
<b>BANK ACCOUNT</b> POD <sup>b</sup> to Joe	Ann	\$15,000		\$15,000	0	0
<b>TREASURY NOTES</b> POD to Ann	Joe	\$10,000	\$10,000		0	0
<b>LAND</b>						
1) Tract 1 (\$100,000)	Ann and Sister (Tenants in Common)	\$50,000 (Ann's Share)		\$50,000	0	\$50,000
2) Tract 2 (\$200,000)	Ann	\$200,000		\$200,000	0	\$200,000
	Total Market Value	\$550,000				
	Gross Estate		\$110,000 <sup>c</sup>	\$360,000 <sup>c</sup>		
	Probate Estate				0 <sup>c</sup>	\$250,000 <sup>c</sup>

<sup>a</sup> Estimate is the interpolated terminal reserve plus the unearned premium. Contact insurer for exact figure.

<sup>b</sup> POD – Payable on Death.

<sup>c</sup> After death of first spouse there is no marital deduction. The rules will change for estimating the gross and probate estate of a widow(er). Surviving spouse should redo this chart to estimate their gross and probate estate.

## Why Have an Estate Plan?

If you own property, at some point in your life, you need to make some basic decisions. You need to think about what you want to happen when death occurs.

- Who do you want to receive your property and your personal belongings?
- Who do you want to act as guardian for your minor children?
- Who do you want to be in charge of distributing your property?
- Do you desire to leave all or part of your estate to a charity or institution?
- Are there those you wish to disinherit?

Thinking about and making these and other decisions is the first step to estate planning.

Obviously, you have the option to do nothing, and you certainly would not be in the minority. But, by **doing nothing** – dying **intestate** or without a will – your estate will be distributed using a “one-size-fits-all” plan. This plan is based on decisions made by the state legislature and known as the “law of succession.”

Without your own plan, someone you’ve never met could actually control the distribution of your assets. But even as cold as that sounds, there are worse things that can happen. Should you die intestate and your property is distributed according to the laws of succession, the fees associated with the legal distribution will substantially reduce the value of your estate.

Attorneys, accountants, appraisers and other professionals, whose services will be required to put things in order, will walk away with a substantial portion of your life’s earnings – not your heirs.

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