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PRACTICAL PLANNER®

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Estate Planning Mistakes

Summary: While estate planning might be one of the most important financial steps you can take, it just doesn't make it to the front burner. Here are some of the common mistakes. Call any of your advisers and make a New Year's resolution to protect yourself and loved ones.

■Mistake #1: The number one mistake is simply not addressing estate planning. The consequences: family fights, significant probate costs, the wrong people inheriting, avoidable tax costs, and more. ■The unpleasantness of dealing with one's mortality is an incredible turn-off. No one wants to focus on issues of death and disability, the realities that you might run out of money if you continue current spending patterns, deciding who will raise your minor children if you are not here... ■The reality is simple, as each of your advisers will assure you. If you deal with issues proactively you are more likely to have a better result. So pull up your socks and "Just do it!"

■Mistake #2: "Estate planning = a will." It is not only about a will. ■Most consumers think an estate plan means a will, but for most that is not the most important document or step. Pension assets and life insurance, which for many people may be the lion's share of their estate, pass by beneficiary designation. Your will may be irrelevant to the disposition of these important assets. (Note that it might make sense to create a special trust under your will for your pension assets direct via a customized beneficiary designation that retirement assets fund that trust). Other assets, e.g. a house or brokerage account that is owned jointly, pass outside of your will to the joint owner. Many people use pay on death (POD) and similar accounts. Those too are governed by the title to the account and not your will. Estate planning can never be only about a will. ■Anytime you change investment firms, buy a new house, or purchase additional life insurance, you need to review the estate planning implications. ■Even for those who put together a will and coordinate beneficiary designations and title to assets, after a few years' pass, the plan can shift out of sync and if not revisited and adjusted can undermine your intent.

■Mistake #3: "It is planning for death not life." Not so, it's the opposite. ■If you're a baby boomer who has retired you have good odds of living three more decades. Shouldn't you focus on planning to be safe and secure for those 30 years more so than focusing on planning to pass assets when you die? ■Perhaps the number 1 planning issue for boomers is having sufficient cash flow for those post-retirement decades. Constructing a budget, coordinating your investment planning, and monitoring it on a regular basis is vital. ■This all needs to be coordinated with your estate planning team. Which trusts, personal accounts, retirement or other "buckets" should assets be held in? Coordinating the income tax and other consequences across this spectrum is vital. ■Aging can be accompanied by declining physical ability and mental acuity. Creating a structure to safeguard your finances, you personally, and your loved ones in advance is a key to planning. ■A funded revocable trust, consideration of professional wealth management and trust services, integration of a care manager into the planning team when appropriate, are all steps to protect you while you are alive. That should be a major focus of planning. ■Many advisers still think of living trusts as a tool to avoid probate. They're missing the boat and you could end up in the surf! Fully funding the trust, getting a trust tax ID number, having a professional successor co-trustee, can all provide

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Checklist: Trust Tips

Summary: Trusts, just like your estate planner, need regular TLC. Here's a few tips:

√ 5/5 Power: Spousal Lifetime Access Trusts (SLATs) are quite a popular planning tool. Husband sets up a trust for wife and descendants and wife sets up a similar (but not reciprocal) trust for Husband and descendants. One of these trusts might include the common estate planning tool of granting the spouse/beneficiary the right to withdraw in her discretion the greater of 5% of trust principal or $5,000/year (called 5/5 power). This is the largest withdrawal right that can be granted without causing tax issues. However, there are consequences to this power. If the money over which the power is exercised each year is not distributed to the non-grantor spouse/beneficiary it could be considered as if he/she made a contribution to the trust and that could make the trust a partially self-settled trust. If that trust is in a state that permits self-settled trusts (e.g., NV, AK, SD, DE) the problem may be mitigated. If the trust is in a state that does not (e.g., NY, NJ) might the trust corpus be exposed to claimants of the spouse/beneficiary? Included in his or her estate? Thanks to Kristen Simmons, Esq. of Oshins & Associates, LLC, Las Ve-

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an incredible security net if Alzheimer's disease or another challenge strikes. ■Recasting estate planning with a focus of planning for life will help you get past Mistake #1.

■Mistake #4: "It's a standard form." Unless your last name is "Standard" whatever documents you get, and however you get them, they need to be tailored to your personal circumstances. ■There is no such thing as a "standard" estate planning document. No form, or plan, is standard. While standard provisions and planning "building blocks" can be used to craft almost every plan, it is the creative and tailored use of those standard steps that will give you the result that works best for you. View estate planning as a Lego set. You can creatively assemble standard blocks into tailored plans that meet your goals. ■That is very different then "I have a will." ■Living wills, which are a statement of your health care wishes, are a great example. You can find free simplistic forms on line. But will they work for you? Most of the generic forms violate the tenants of every major faith. So if you sign a "standard" living will, you may violate your fundamental beliefs, and wreak havoc as your loved ones try to sort out the inconsistencies. ■Powers of attorney, which designate an agent to handle financial and legal matters if you cannot do so, are ubiquitous in planning. But "standard" is a dangerous word. ■Most form powers include gift provisions permitting agents to make annual gifts. In 1987 you could gift $10,000/year and the lifetime exemption was a mere $600,000. Gifting was real important then. ■In 2015 the annual gift exclusion is $14,000 and the federal exemption is $5.43M. For the majority of even wealthy Americans annual gifts are passé. ■But using a "standard" power of attorney with a broad gift provision could expose you to elder financial abuse. Perhaps most powers should prohibit gifts. ■On the opposite end of the wealth spectrum, a high net worth family might want a broad gift provision permitting gifts of any unused exemption to capture annual inflation increases. You might also benefit from express powers to your agent to exercise a swap power under a grantor trust.

■Mistake #5: "Only very wealthy people need planning." Another favorite is "My estate is too small/ simple to need planning." Not true. Everyone needs planning no matter how rich or poor, you just need appropriate planning. ■If you become disabled in your 40's from a work related injury, skiing accident, or illness, what is simple? Someone who is wealthy might have adequate resources to fund living expenses. Few people, especially at a young age, have adequate resources to fund decades of living expenses. Having a disability income replacement policy, a buyout agreement for your business and other steps is vital for most people. ■If your resources are limited at any age and you don't have the appropriate documents in place to address the issues that will arise upon disability, a court appointed guardian may be necessary. That can be costly and may not result in the person you want controlling your personal or financial decisions. ■So, even if you are of more modest means, having a durable power of attorney, health proxy and a revocable living trust, a financial plan to provide a framework for your fiduciaries, etc. is vital. It is more vital perhaps then for someone of substantial means who may have an army of advisers that can assist the family (the ultra-wealthy need this planning too, just different). ■It is often a fallacy to think that having less money makes your estate plan simpler. "I don't need trusts, we don't have that much money." For a wealthy family there is ample money to cover college, medical, and new home costs for all. For a family of lesser means, parsing the myriad of options, and prioritizing limited resources, in a cost effective manner is far more of a challenge then completing a $5 million transfer to a GST trust. Wealthier families can easily hire a major trust company to invest family resources and use their 100 years+ of experience to distribute funds in a rationale manner to accomplish family goals. Families of more limited means may have to rely on family members to handle these delicate Solomon-like tasks. PP

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PLANNING POTPOURRI

■ Succession planning is vital for every closely held business owner. For many estate plans it might be the single most important business decision you will ever make. You should consider all your strategic options. Transitioning a business to children or other heirs is certainly an option, but realistically, it is not always viable. Other options are: Should you sell your entire company? Or instead take some money off the table now - by selling part of your company or partnering with another entity - and then get another bite of the apple later on. This might be a larger company looking for strategic value in your business, or a financial investor (a private equity firm, or a leveraged buyout fund) looking to enter your market. To succeed you must consider more than just having a qualified heir or the right legal documents. If you don't think the plan through with investment bankers or business consultants, the best laid plans may not succeed. For example, some markets, like retail, are facing greater competition from ecommerce. That may affect the businesses viability. So the time to plan is now, not tomorrow. In other markets, riding the impact of new technologies, may result in explosive growth. For these companies, the transition process may require an infusion of capital or additional expertise to successfully take advantage of these opportunities. Merely handing off to the next generation, even if they are capable, may not always work. Too often succession planning hinges on the readiness of the Patriarch or Matriarch to undertake the requisite steps. But that alone won't always suffice. Is the business itself ready for the transition options? Does your business have the right financial reporting, internal controls, or management depth? Too many closely held businesses run like a family piggy bank – kids on the payroll, cars, travel and other personal expenses run through run through the books, etc. Others understate inventory to lower reported income. If you want to show the real value of your company to a suitor, you may need to clean up loose practices and be in a position to justify a recast of your earnings. Also, succession timing may not be something you can control. You may get an offer tomorrow, or health and circumstances may change abruptly. It can be advantageous to engage a consultant in advance and groom the company to keep your options open. Thanks to Michael Richmond, of the DAK Group, Ltd., Rochelle Park, NJ. PP

Practical legal stuff... in plain English

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...CHECKLIST: TRUST TIPS

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gas.

√ Don't Pay Your Trustee Bill: Many trust companies send bills for their trustee fees and other charges to the grantor/settlor of the trust. This might be a result of state law, or trust company policy. These costs in many cases should be paid directly by the trust, not by you the grantor. The payment by the grantor may constitute an additional gift to the trust with gift and GST tax consequences, trigger the need to file a gift tax return, etc. If the amount is paid by someone other than the grantor it could create worse complications. Before paying trust bills consult with your tax adviser. If your trust company can put trust charges on autopilot and deduct them from the trust, even better.

√ QTIP ESBT: When a Qualified Terminable Interest Property (QTIP) marital trust owns stock in an S corporation special precautions must be taken to protect the tax favored S-election. Historically most QTIPs would elect Qualified Subchapter S Trust (QSST) status. The requirements for both QTIP and QSST of passing income to the spouse/beneficiary are consistent. However, it might be more advantageous in some instances when the trust and spouse are in the maximum income tax brackets to have the QTIP elect Electing Small Business Trust (ESBT) status. If the trustee is active in the S corporation business, and the spouse is not, this approach might avoid the 3.8% Surtax on NII-year after year.

√ Divorce Planning: Most estate plans endeavor to address the risk of an heir divorcing. A key to protecting gifts and bequests is for them to be held in trust to protect a beneficiary. But merely using a trust will not assure the desired level of protection. The trusts must be formed and administered properly. If you have separate/immune assets held in a trust but pay the income tax triggered by the trust out of marital property, that may weaken the protection the trusts affords. If you commingle trust and marital assets you may undermine the trust plan. While trusts can provide substantial protection, failing to monitor the details of operation of the trust may be fatal.

√ Life Insurance Trusts: If you have an insurance trust, or if you are serving as trustee, the trust, life insurance and overall plan is unlikely to succeed unless you periodically (every 2 years) have an insurance expert review the life insurance held in the trust to confirm it is performing adequately, that the insurance carrier remains strong, the coverage meets current needs, and so forth.

√ Complex Trust Distributions: Many modern trusts are structured as grantor trusts, with the grantor paying all income tax. Other trusts are "complex" trusts in that there is discretion to pay out income. If income is paid out the beneficiary will generally bear the tax cost. If it is not the trust will pay the tax cost. Since trusts hit the maximum income tax bracket at about $12,000 of income paying out income to lower bracket family members can save federal income tax, avoid the 3.8% Medicare Surtax, and might save state income tax depending on where beneficiaries reside. Coordination of your estate planner (to determine what the trust provides and to consider non-tax factors), your wealth manager (gain harvesting) and your CPA (tax) is a must. Authorize your advisers to collaborate to get the best results. PP

RECENT DEVELOPMENTS

■ Tax Figures: Why do all your rich neighbors live in Miami? ■The NYS estate tax exemption is being phased up to the federal amount in 2019. In April 2015 the exemption will be $3,125,000. Be wary, exceed that by 5% and the exemption is lost. This gem is affectionately referred to as the NY "cliff." Don't fall off! ■The NJ exemption remains at $675,000. If a NJ taxpayer moves permanently to NY might the tax savings pay for the cost of that NYC apartment? ■CT exemption remains at $2,000,000. CT has a gift tax, and NY during its phase in of the exemption may recapture gifts in the calculation. ■Other new figures for 2015: The top tax bracket of 39.6% for married taxpayers kicks in at $464,850 in 2015. The Personal Exemptions Phase-out (PEP) begins at $309,900. Itemized deductions are phased out by 3% of adjusted gross income (AGI) over the PEP amount or 80% of itemized deductions reducing the benefit of state taxes, mortgage interest and contributions. ■Non-Grantor trusts hit the maximum bracket of 39.6% at a mere 12,300. The annual gift exclusion is $14,000/done and $147,000 for a non-citizen spouse.

■ Stored Reproductive Material: A recent NY law addresses the impact of reproductive technology on estate planning. Reproductive material might include sperm, eggs or embryos stored by a someone, for example, prior to undergoing chemotherapy. One of the controversial issues this material can raise is should a child born from such stored material, especially after the donor/parent's death, be entitled to inherit. If the material is used years after someone died, and without their knowledge, should that child be a beneficiary of a trust the deceased donor/parent created? NY has endeavored to provide some clarity and parameters to these issues. If you store material you have to authorize its use after your death in writing and designate an agent to make decisions. For a posthumous child to inherit the agent you appoint must give notice to your executor within seven months of the executor's appointment. The child must be in utero within 24 months of your death, or born within 33 months. PP