



# The Wealth Advisor

## Using the Power of Trusts to Spur Your Estate Planning

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Estate planning changed again on January 1, 2011, when certain key provisions of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, signed by President Obama on December 17, 2010, took effect.

Suddenly, the federal estate tax exemption increased to \$5 million (\$10 million for a married couple with proper planning). As a result, most people are not affected by the federal estate tax if they die this year or next. Because the news reports did not focus on the "this year or next" part, many people took this to mean that they no longer need to do *any* estate planning. But that couldn't be further from the truth. Most of the reasons families need to plan their estates are unrelated to estate taxes, and those tax changes are only until 2013.

In this issue of *The Wealth Advisor*, we will look at what people want in their estate planning, why failure to plan is courting disaster, and how the power of trusts can help you achieve your estate planning needs and desires.

### Changing the Focus . . . For Now

For years, one of the major factors in estate planning was avoiding the federal estate tax. Until 2000, the estate tax kicked in at \$675,000. As the estate tax exemption began to increase, albeit only for those who died before 2011, that motivator declined in significance. The new law temporarily removed tax planning as an immediate need for the vast majority of Americans. Some have been lulled into a false sense of security thinking that the estate tax will never affect them. They have lost sight of the fact that the current tax law was only a two-year deal that Congress made with the President. It expires on January 1, 2013, and could end sooner. It came out of a compromise quickly reached. And so could the next tax change.

Don't use the "wait and see what Congress will do" excuse to postpone your estate planning. Now, not later, has always been and remains the right time to focus on what you and your loved ones really want and need from estate planning.

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## **What Do People Want from Estate Planning?**

Most of us have needs and desires for ourselves and our loved ones that are timeless and that no Congress can ever legislate away. See how many of these apply to you.

***For Ourselves: Protection and Control.*** We want control over our assets and health care decisions. We want financial security. We want to be protected from the risks of life, which include unjust lawsuits, disability, and the cost of long-term care. Some of us have philanthropic goals, too.

***For Our Surviving Spouse: Financial Security.*** We want to know that our surviving spouse will be financially secure and will be protected from taxes, primarily from income tax.

***For Our Children and Grandchildren: An Education and Financial Security, including Asset Protection from Immaturity, Divorce and Lawsuits.*** We also want to know that assets that are not needed by our surviving spouse will go to our children, not to a new spouse and then his or her children.

Another big motivator for planning can be protecting assets from gift, estate and income taxes for as long as possible, which today can be forever. We want our descendants to live successful lives that include a work ethic, integrity, faith, and appreciation and respect for other family members. Above all, we want our family members to love each other, spend time together and avoid conflict. We do not want them to be harmed by the wealth that is left to them. This is often far more important to us than tax planning.

***For Our Business: Attract and keep quality talent and preserve the value we have built up through our hard work.*** Building a business, whether it is a store, manufacturer, or agricultural operation, is hard work. We don't want that work to have been wasted. We want our business to pass to family members who want to own and operate it, while treating non-participating family members fairly, or we want to sell it to employees or outsiders for a fair price.

## **The Consequences of Not Planning**

Each of these needs and desires requires proper planning to achieve. They will not just happen because you want them to. If you do not plan, you and your family will be under the default plan established by your state's legislature. Sad experience tells us that it very probably will not be what you would want.

For example, in most states, your estate will be divided between your surviving spouse, who will get half, and your descendants, who will get the other half. In some states, all would go either to your surviving spouse or your children, depending on the facts of your case. Under any of those systems, your surviving spouse might get fewer assets than needed or intended. Under every state's default laws, adult children receive their full inheritances right away and minor children receive theirs when they turn 18, both with no controls or conditions. Without a plan to replace you as owner, your business may have to be liquidated.

The simple truth is this: to meet your needs and realize your desires you must take the time both to plan and to put that plan in place.

## **How to Find the Right Professionals to Help You**

Instead of looking for someone who will sell you a will, a living trust or an insurance policy, look for professionals who are interested in protecting you, your family and your business. They are not just selling you a product and then moving on.

You will be best served by working with a team of professionals: an experienced estate planning attorney, an accountant, a financial advisor and/or insurance agent, possibly even a planned giving professional. This team will be able to provide thoughtful solutions to your needs from a variety of perspectives, coming up with a cohesive plan that will best suit your needs and goals. Be patient during this process; it could take two to four meetings before everything is finalized and put into place.

**Planning Tip:** Start with a trusted advisor and ask for recommendations for others who could be brought onto your team. Also, if there is anyone else (good friend, relative) you might consult, be sure to let the team members know. It may be helpful to have that person included at some point in the process so they will understand what your advisors are proposing, and that will allow this person to be a better sounding board for you.

## **Harnessing the Power of Trusts in Your Planning**

Trusts are powerful tools that can be used to achieve specific estate planning goals. Here are some ideas, using trusts, that will work for most people, regardless of the size of your estate.

### ***Idea #1: Keep Assets in Trust***

Holding assets in trust is good for you, for your surviving spouse, and for your children and your grandchildren. Assets kept in a trust can be protected from predators (including your surviving spouse's next spouse), irresponsible spending, creditors, divorce, etc. Assets in a trust can also provide for a loved one with special needs, without losing valuable government benefits. Ask yourself this question: If you could protect the assets you worked so hard to acquire, why would you not?

### ***Idea #2: Think Differently about Your IRA and Other Tax-Qualified Plans***

Most people want to maximize the stretch out of an IRA and keep the tax-deferred growth going for as long as possible, but don't know how best to do it. There is a way to use a special trust to maximize stretch out and provide long-term divorce and lawsuit protection. And it will apply to many families with "average" sized estates and IRAs.

**Step 1:** Leave your IRA to a retirement plan trust for the benefit of younger generation family members (children or grandchildren). The young age will provide the maximum stretch out and the trust will provide them protection from losing it in a divorce or to creditors. An outside trustee can prevent a beneficiary from "cashing out early" and preserve the intended stretch out.

**Step 2:** Use the required minimum distributions you must take from this IRA to purchase life insurance on your life. But do it through an Irrevocable Wealth

Replacement Trust that will benefit your surviving spouse. When you die, your surviving spouse will have lifetime access to the proceeds in the trust. This can be a much better deal for your surviving spouse than inheriting the IRA because the distributions from the IRA will be subject to income tax, while the proceeds from the life insurance in the trust will be tax-free. The trust design will provide for successor beneficiaries if your spouse dies before you.

To make these benefits clear for you, we can run projections with your spouse as the beneficiary of the IRA and a child/grandchild as the beneficiary. The results will be quite impressive.

*Charitable Variation:* Alternatively, you can make a charity or religious group the beneficiary of the IRA, and it will receive the proceeds tax-free. Again, use the required minimum distributions while you are living to purchase life insurance through an irrevocable trust that will benefit your surviving spouse.

***Idea #3: Use the \$5 Million Gift Tax Exemption Now***

In the new tax law, Congress also temporarily increased the gift tax exemption to \$5 million (\$10 million for married couples). We may have this through 2012, but it could disappear even sooner as Congress begins to focus on how to raise revenue and cut spending. If you have a substantial estate, you can use this exemption to move assets and future appreciation out of your estate now in the likely event that a lower estate tax exemption returns.

For example, you could use the \$5 million gift tax exemption to fund a large life insurance policy in an irrevocable trust that can build up cash value for a supplemental retirement fund or provide an alternative financial investment. A second-to-die policy to pre-fund estate taxes could also be purchased. The \$5 million exemption can also be used to fund other "advanced" planning options.

**Planning Tip:** There are two relatively easy ways to give you access to insurance owned by an irrevocable trust. First, the trust can be set up so that the trustee can make withdrawals or loans from the cash value of the policy and then lend the proceeds to you. It can be an interest-only loan during your lifetime, with no additional income tax due; at your death, the loan can become a debt of your estate. (It must be a credible loan, fully documented, and you must have the means to make the interest payments.) Alternatively, the distributions can be made to your spouse, on the assumption that you will stay married and your spouse will "share" the proceeds with you.

***Idea #4: Use Trusts to Create a Non-Financial Legacy***

Creating a non-financial legacy can be quite powerful. You can write your motivations for the planning and explain discretionary guidelines. If there is heirloom property that is sentimental or historical, you can provide a handwritten note with a story or significance of the item(s).

After your trust has been signed and your plan put in place, we can arrange for a family meeting: in person for those who live in the area and/or via Skype for out-of-town-ers. We can talk about the planning that has been done and why. This is good for your beneficiaries, as it brings them into the process and helps them understand your motivations, the planning and your intended results.

## Conclusion

The new tax law has definitely not changed the need for each of us to make and implement an estate plan. It has only changed the need for estate tax avoidance for those who are certain to die before the end of 2012.

The power of trusts can be a big motivator and can help you achieve your goals. Don't sit around waiting to find out "what Congress will do" and hoping it will be good for you. Call us. We can help you understand where you are now, put together a team of qualified professionals, help you determine your needs and goals, work with you to create the plan you want and need, and help you put your plan in place.

## Test Your Knowledge

1. With the new tax law, most families don't need to do any estate planning. **True or False**
2. Rather than do any estate planning now, it is better to wait and see what Congress will do about estate taxes in the future. **True or False**
3. Most of us do not care if our assets pass to our surviving spouse's new spouse. **True or False**
4. Most of us do not care about protecting our assets from our children's immaturity, divorce and lawsuits. **True or False**
5. I don't really need to do any planning. The state in which I live will make sure everything is distributed the way I want. **True or False**
6. The best way to plan my estate is to find someone who will write a will or living trust for the cheapest price. **True or False**
7. Assets kept in a trust are not protected from irresponsible spending, creditors or divorce. **True or False**
8. I should be able to have my estate plan finished in one quick meeting. **True or False**
9. It is always better to name my spouse as the beneficiary of my IRA. **True or False**
10. If I leave my IRA to a charity, the charity will have to pay taxes on it. **True or False**
11. After I have my estate plan completed, it is best to hide it and not tell any of my beneficiaries what is in it. **True or False**
12. There is no rush to use the \$5 million gift tax exemption because it will be

here for a long time. **True or False**

*Answers: All of the answers are false.*

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