Course Objective

This course was created to teach advisors (CPAs, EAs, accountants, attorneys, financial planners, and insurance advisors) about the basic elements of estate planning and the tools used to help clients. Most advisors are aware of wills, trusts, durable powers, irrevocable life insurance trusts, generation skipping tax exemption trusts, but many times clients do not have these basic tools or, if they do have them, they are not set up correctly. This material will remind and refresh the memories of advisors who already should know this material and point out why many of their clients probably need to have their "basic estate plans" fixed or updated.

Estate Planning
The Basics

Preface

There are week long courses that advisors can attend on estate planning. In law school, attorneys take multi-semester courses covering the many different aspects of estate planning.

The following material will cover the basics of estate planning, but will not cover the following planning tools:

-Life Insurance
-Annuities
-Disability Insurance
-Long Term Care Insurance
-Charitable Planning
-Life Settlements
-The 70-80% Tax Trap

Each of these has its own 25+ page section where they will be discussed in depth (including how they are used in estate planning).

Introduction

When I travel around the country giving seminars, they are advertised as providing information on asset protection, and income and estate tax reduction. In the normal seminar, I also cover several estate planning mistakes I see over and over again with many clients.

The ironic thing is that most clients think their estate plans are set up correctly. Everyone is confident that their estate planning attorney and CPA/accountant know what they are doing. While it is true that many advisors know how to develop a complete estate plan, rarely does it happen.

I will list some statistics from my seminars that should hold true to the clients of many of the advisors reading this material.

Out of ten clients who attend my seminars:

One or two will **NOT** even have a simple will. Usually these are the younger clients. (Without a will, clients will be allowing the state they live in to dictate who gets their assets at death).

Nine or ten will **NOT** have Durable Powers of Attorney. (Durable Powers deal with what to do with a client in the event they become incapacitated, or, should the situation arise, where a decision needs to be made about discontinuing a feeding tube to sustain life).

Five or six will **NOT** have marital trusts (A&B, marital, or living trusts are used to maximize estate tax exemptions which can save the heirs of an estate $500,000 in estate taxes. Trusts also avoid the probate process, which costs between 4-8% of the entire estate).

Nine or ten will **NOT** have a Family Limited Liability Company or Family Limited Partnership. (FLPs are used to discount the value of an estate).

Seven or eight will **NOT** have an Irrevocable Life Insurance Trust (ILIT). (An ILIT will pass the death benefit from a life policy both income and estate tax free to the heirs/beneficiary).

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These are just the basic tools that are needed in almost every estate plan of a client with any amount of wealth.

If your clients do not have the basic tools, they could be sending millions of dollars to the government via taxes, or to the probate system via fees. While your clients will be dead and will not have to worry about it, their children (or any heirs) will curse the them and will, potentially, look to the advisors who set up the faulty estate plan for an explanation, which could ultimately lead to a malpractice or E&O issue..

This material will explain how each of these works, and why clients would want each one in their estate plan. They may have a will or A&B trusts; but if they are like many of the attendees at my seminars, they have no idea why. My point being, even if you are knowledgeable about the tools outlined above, reading the following material will increase your knowledge and show where you can look to benefit current and new clients when examining an incomplete estate plan.

Think about the following statistics:

Age	Odds of Death Before Age 65
35	27.5%
40	26.4%
45	24.8%
50	22.4%
55	18.4%

Wills

A will is the most basic tool in a client's estate plan. An attorney starts with a will; and then adds different estate planning documents as the client gets married, has children, and increases the value of his/her estate. There is nothing terribly exciting or unique about a will; so we will not spend much time on it. There are a few items you need to keep in mind.

If clients do not have a will when they die, they will have died "intestate." That simply means that the property in the client's estate will be divided according to the state's statute on intestacy. In every state, there is literally a list of who gets what, and in what percentages when you die. If you are married, some states pour the entire estate to the spouse; however, that is not always the case.

I would suggest that you check your state statute and keep a list of how the assets will be distributed in the event a client dies without a will. Don't just

look at the list after learning of a deceased client with the problem (because that would mean the advisors failed the client by letting him/her die without a will), show it to a client who needs to be motivated to get a will.

How much should a will cost?

Not much. Clients should be able to get a will (and one for a spouse) for $150-$250. Attorneys do not do much when creating a will; however, the professional liability with the document created lasts for the life of the client, thereby justifying the fee.

How often should a will be updated?

Your clients should update their wills any time they get married, have children, get divorced, increase the value of their estate, if a child happens to predecease them, or if the tax laws change. Clients should also update their wills if they do not have A&B marital living trusts and want to change who gets what when they die.

Why don't clients just handwrite a will instead of pay for one?

A handwritten will is called a holographic will, and many states do not recognize holographic wills as a legal document. I do not have any problem if your clients are too cheap to hire an attorney to draft a will, but make sure your state allows for holographic wills before allowing your clients to use them. And if your clients use holographic wills, make sure they follow the rules. I do not suggest a holographic will because I believe nearly every estate plan should have A&B trusts, which should be drafted by an attorney.

Can clients leave their spouse out of a will?

Many times a client will take on a second spouse later on in life. This typically happens when a male client has a mid life crisis and "trades up" creating a situation where the client does not want the new wife to take from the will.

Most states do not allow you to cut your spouse out of your will, so just make sure you check your state laws before allowing your clients to do anything drastic with their will. Also, when a client gets divorced, they should immediately change their will so the ex-spouse does not have a claim to some of the estate.

In some cases, a divorce which is high profile and has substantial asset or income issues, will continue for a year or more. In such cases, if the client continues to have the old will in place and happens to die, there is a strong

argument to be made that, although the client was estranged from the soon-to-be ex-wife, she/he still gets to take from the will as if she/he were still married to client (which is true at the client's death since the divorce was not final). If that happens, the soon-to-be ex-wife typically will receive the majority or all of the estate instead of the state mandated minimums for widows (widow's election).

If you want a client to turn over in the grave, have one die during a divorce and look down from above and watch as the soon-to-be ex-wife spends all money.

Those clients with complicated divorce cases should be advised to consult both their divorce attorneys and their estate planners to consider **changing the will during the divorce process** while the spouse is estranged. After the divorce is completed, another will should be completed to deal with the post-divorce situation.

Conclusion

Everyone should have a will if for no other reason than to prevent the state from dictating who gets the estate when you die. Wills are inexpensive and not time consuming to put in place, and so I do advocate that everyone obtain a will as soon as practical in life.

Durable Powers of Attorney

What is a Durable Power of Attorney (DPA)?

It is expected that, during the course of our lives, we may become incapacitated and unable to act either because of a physical infirmity or mental incapacity. When that happens, it is important to have someone you love or trust with a Durable Power of Attorney (DPA) in place to deal with the day-to-day issues of our lives when incapacitated.

A DPA is a document that allows a person or entity, referred to as the attorney in fact, to act on behalf of the person giving the Power.

A Durable Power of Attorney is needed to allow the designated agent to handle financial transactions, such as writing checks, voting stock rights, and, generally, to act in all matters of a financial and/or legal nature for the principal who is unable to act for themselves.

When most people hear the words "Power of Attorney" they are on guard. They think that they might be giving away some power that could be abused, and cause the person authorizing the Power harm. In reality, a *DURABLE POWER*

OF ATTORNEY is actually something that could save your client's estate money and time.

Why would such a document save time and money?

Let's assume you are in good health and still gainfully employed. You suffer an accident resulting in a total mental or physical incapacity. If you do not have a Durable Power naming your spouse or a trusted relative to act in business matters, such as paying bills, paying taxes, and signing business papers, or contracts for services or products, then your family will generally have to go to court and ask the court to determine that be given these powers that would have otherwise been included in the Durable Power document. The court will typically require notice to others and a hearing and testimony, including possibly some independent expert testimony concerning the extent of the disability, to allow the spouse or trusted relative to act for the incapacitated person.

The hearing procedure, generally referred to in most states as a conservatorship or guardianship, is time consuming, expensive, and, generally, will require the services of one or more attorneys.

Had you simply implemented a Durable Power of Attorney, signed in advance of the hardship or incapacity, that document would render the court hearing and court orders unnecessary.

What kind of Durable Powers are there, and what should you inquire about when your clients have to have one drafted?

In the above example, if you had a retirement account, pension accounts, Profit Sharing, stock bonus plan, and Keogh or other retirement plans, a Durable Power could have language which would allow the appointed person to act for you in regard to those accounts. This is an important issue for a client's spouse when the couple is retired, for example, and is primarily living off the income from an IRA. Depending on the circumstances, without a DPA, the spouse might not be able to access the money from that IRA without going to court to have someone appointed to act on behalf of the incapacitated spouse.

Some DPAs have "**springing powers**" which are only effective upon disability and will, generally, terminate when the disabled client becomes capable or is no longer disabled. Usually these springing Powers of Attorney are activated when one or two physicians, stating the nature and extent of the disability, verify that the DPA should be used; and when the period of disability ends, the physicians will determine that the incapacity has ended, and the need for the use

of the Durable Power has ended, thus putting the client back in charge of his/her affairs.

Other powers are effective upon signing, and allow the designated attorney to act for the incapacitated person immediately. One should always check resident state laws to determine what flexibility is allowed under that state in developing a Durable Power of Attorney.

Powers of Attorney can even provide for the delegation of an agent's power to deal with a Section 529 college education savings plan account(s). All Durable Powers of Attorney or springing Durable Powers should include specific language that allows the "attorney in fact" to create, open, or invest the owner's assets in a Section 529 account, to maintain that account, and make decisions with regard to handling account disbursements, or to change the designated beneficiary of a Section 529 account.

Durable Powers can provide for another person to make gifts for the principal, appoint a separate agent to vote stock, make business decisions, and so forth.

Delegating medical treatment options and/or directives

In some states, Michigan is one, a Durable Power of Attorney can also appoint an individual called a Patient Advocate (PA) to make medical treatment decisions if the individual is at least 18 years of age and of sound mind when the power was signed. Usually this kind of patient advocate form would include language typical of the "living will" in which the quality of life of the grantor is stated. In most cases, the Durable Power might now include patient advocacy matters, and a separate document called a "Patient Advocate" form would be used to cover the issue of the treatment, or removal thereof, of the patient. The Living Will used in some states would be similar to the Patient Advocate form, which attempts to accomplish the same objective of appointing someone close to the nominee to make decisions concerning medical treatment or the lack thereof.

Why is a Patient Advocate Designation or Living Will important and why clients should have one?

Many Americans die in a hospital or other care facilities. Physicians and health care workers who work in these facilities are generally charged with preserving a patient's life. Clients may or may not want a physician or hospital making decisions about their care when incapacitated. Health Care Directives give clients the opportunity to write out their wishes in advance and ensure some legal respect for them if they are ever unable to speak for themselves.

What is a Living Will?

A Living Will, known in some states as a Health Care Directive, sets out a person's wishes about what medical treatment should be withheld or provided if a person becomes unable to communicate those wishes. The directive creates a contract with the attending physician. Once the physician receives a properly signed and witnessed directive, he or she is under a duty either to honor its instructions or to make sure the patient is transferred to the care of another physician who will honor them.

Health Care Directives are not used just to instruct physicians to withhold life-prolonging treatments. Some people want to reinforce that they would like to receive all medical treatment that is available, and the Patient Advocate Form or Health Care Directive is the proper place to specify that.

In most states, you must be 18 years old to sign a directive of this nature; and every state law requires that the person making a Health Care Directive must be able to understand what the document means, what it contains, and how it works.

If clients are physically disabled, they may make a valid health care document by simply directing another person to sign the document if they are unable to sign it for themselves.

If a client does not have a Medical Directive, a Living Will or Patient Advocate Form or Durable Power with medical directives signed, then the physicians who attend to the client will use their own discretion in deciding what kind of medical care will be received.

Problems also can develop when family members are not in agreement as to what type and extent of medical treatment clients should receive or not receive. In worst cases, the court will be forced to decide these cases even though the judge has little medical knowledge and no familiarity with the client. These legal court wars are usually expensive and begin to use up the financial resources of the person incapacitated who would have otherwise, given the choice, not wanted the heirs battling over the extent of medical treatment and expensive legal fees and costs.

The execution of a Living Will, Patient Advocate Form, Medical Directive, and/or other appropriate Durable Power would save time and the expense of a court trial.

A Health Care Directive can take effect when the client is diagnosed to be close to death from a terminal condition or to be permanently comatose, and is are unable to communicate his/her own wishes for medical care. Under these circumstances, the Medical Directive can be given to the medical personnel

taking care of the client; and that Medical Directive with specific instructions should then be followed.

The directive should be made part of a clients' medical records when they are admitted to a hospital or other care facility. Since it is possible that the need for care may arise unexpectedly, or while they are out of their home state or country, it is best to give copies of their completed documents to their family and their personal physician.

Conclusion

Durable Powers and Patient Advocate Forms should be incorporated into every estate plan so as to avoid delay in medical treatment or the payment of household bills. As an attorney who has seen the kind of litigation that can be required to have a court determine who will have the authority to pay bills and make determinations about a client's medical care (life and death decisions), I can state with confidence that not having Durable Powers and Patient Advocate forms in a client's estate plan would be a tremendous mistake.

Annual Gift Tax Exclusion

The annual exclusion amount has increased in 2013 to $14,000. This means an individual may gift up to $14,000 in 2013 (per donee) without the necessity for filing a gift tax return or using any portion of his or her lifetime exemption amount. For married couples, they may combine their annual exclusion amount to gift up to $28,000 per donee.

When helping clients reduce the size of their estates or simply to help them make gifts that will not force them to use part of their gift tax exclusion, being able to gift outright or to a trust $14,000 per spouse per donee is very helpful.

A&B, Marital, or Living Trusts

Besides a will, A&B/marital/living trusts (hereinafter A&B trusts) are the most commonly used estate planning tool and one that should be recommended in nearly every estate plan. This assumes that the client is married. If a client is not married, he/she would simply have one living trust which would have the same advantages in Number 1) below. If the client is not married, he/she cannot take advantage of Number 2) below, which discusses maximizing estate tax exemptions among spouses.

This material does not cover how to use A&B trusts in community property states. If you live in a community property state, you can read about how planning differs in a separate education module specifically created for advisors who practice in community property states.

What are the benefits of A&B trusts?

1) The first benefit of having A&B trusts is that the estate assets owned in trust will not be probated through the court system. The client's will does end up being probated, but again, the assets owned in trust will not. When that happens, the estate will typically be probated in an "unsupervised" manner where the court does not have to probate everything in the estate; and when this happens, the beneficiaries save (depending on the state) between 1-8% (4-6% is average) of the **entire value of the estate** in probate fees.

One of the benefits of having assets pass through trusts vs. through probate is the added privacy. When the assets are not "probated," the general public does not have a chance to see what assets flow through the estate. For clients who have privacy concerns, the use of A&B trusts provides an added benefit.

2) A&B trusts maximize your estate tax exemptions. The estate planning world was turned upside down at the end of 2012 when Congress passed the American Taxpayer Relief Act of 2012 (cutting a deal to let the Bush era tax cuts expire on wealth clients in partial exchange an increase in the estate tax exemption). The exemption when passed was $5,000,000 per person (indexed for inflation). The top estate tax rate is now 40%.

Exemptions and Maximum Tax Rates		
Year	**Estate Tax Exemption**	**Highest Rate**
2013 and beyond	$5.25 million (indexed for inflation)	40%

Portability

Prior to the recent "permanent" estate tax exemption law changes enacted at the end of 2012 and the temporary ones prior to (going back to 2010), when one spouse died without using his/her exemption property, the exemption died with that spouse. That's why it was vital to have properly setup A & B marital trusts.

Let's explore the history of the exclusion a bit with information pertaining to how portability affects today's planning for clients.

Portability Allows Married Couples to Share Estate and Gift Tax Exemptions

A basic concept in federal estate and gift tax planning is the unified credit—now referred to as the applicable exclusion amount—that represents the amount a taxpayer can leave to heirs free of federal estate and gift tax. The amount of this exclusion has increased over the years from $600,000 in the 1980s to $5 million in 2011 and 2012. Married couples can leave twice this amount since each spouse has a separate exclusion.

For years, an important part of estate planning has been making sure the assets of a married couple were properly titled so their estates would get the benefit of using both of their exemptions. The idea was to ensure no matter which spouse died first, sufficient assets would exist in the first estate to fully utilize the exemption. This often led to retitling assets from joint names to individual names, which may have been contrary to how the clients wanted to own their assets. Estate planners would advise they had to do it for "tax purposes." It was an example of the tax tail wagging the asset dog.

In recent years, many in favor of tax simplification suggested it would make sense to allow a married couple to share their two exemptions, regardless of which spouse dies first and how the assets are titled. If the first spouse to die does not have sufficient assets to fully utilize his or her exemption, then the unused part would be available for the surviving spouse to use in the second estate. This sharing of the exemption amount became known as portability.

The Tax Relief Act of 2010 enacted portability into the law for tax years 2011 and 2012 by amending Section 2010(c) of the Internal Revenue Code. It created an election for estates of decedents dying during those two years to make the deceased spouse's unused exclusion amount (DESUEA) available to the surviving spouse, both for gift and estate tax purposes. The election is made on the federal estate tax return in the first estate that will require estates to file returns even if the size of the assets is well below the exclusion amount. The result may be more estate tax returns being filed even though one would otherwise expect the new $5 million exclusion amount would result in fewer estates filing returns.

While the concept of portability is appealing since it could make estate planning for married couples less complicated, its use in practice will be anything but simple. Many factors will be involved in deciding whether to take advantage of portability:

- Portability law was codified in the American Taxpayer Relief Act of 2012 and is "permanent." go away in 2013.

- Portability only applies to the last deceased spouse's unused exemption. If the surviving spouse remarries and survives the second spouse, the first deceased spouse's DESUEA will be lost. This is a much worse result than if a trust had been established on the first spouse's death to preserve the exemption for the benefit of the children or other heirs.

- There are also tax basis issues to consider. In traditional unified credit planning, a trust would be created on the first death to capture the exclusion of the first spouse. While the assets will receive a step up in basis on the first death, the assets do not get a second step up on the second death. With portability, if all of the assets are left to the surviving spouse, all of the assets will get a step up at both the first and second deaths. In other words, portability can reduce capital gains taxes the heirs will pay when they sell inherited assets.

- Portability applies for estate and gift tax purposes, which allows the surviving spouse to make gifts to utilize the DESUEA.

- Portability does not apply to the generation skipping transfer tax (GSTT). Therefore, the GSTT exemption of the first spouse would be lost if all of the assets are left to the surviving spouse, who is planning on using the DESUEA to exempt those assets from estate tax in the second estate.

There are many reasons to use trusts aside from potential tax savings. These include asset protection, preservation of assets for remainder beneficiaries, professional management of assets and protection of assets in the event of divorce. In second marriage situations, clients often want to ensure assets will go to children from the first marriage after the death of the second spouse. In first marriage situations, many clients are concerned their spouse could remarry and leave their assets to the new spouse rather than their children. Trusts can help in all of these situations, regardless of any tax considerations.

What should A&B trusts cost?

Size of the estate	Cost
Up to 3 million	$2,500
3 to 5 million	$3,500
5 to 10 million	$5,000
10 to 25 million	$7,500
over 25 million	$10,000

It's upsetting to hear that clients have paid $25,000-$50,000 or more for estate plans. Unless your clients' estates are over 15 million dollars, they should be able to get an entire estate plan for less than $15,000. If the estate is less than $5,000,000, a client should be able to get an entire estate plan done for

around $5,000. (That does not include a lot of specific asset protection planning or advanced planning with FLLCs).

If you are wondering why estate plans can get costly when the same shell documents are used over and over, it is because of the lingering liability with the estate plan. The malpractice liability for estate planning attorneys does not go away until the client dies, which could be 50+ years for some clients.

Revocable

A&B trusts are revocable trusts. It is very common for an attorney to set up A&B trusts and not put anything in the trusts. I would say that 80% of the A&B trusts out there are not funded. If, for whatever reason, clients want to take assets out of their trusts it is not a problem since the trusts are revocable (I will discuss irrevocable trusts in an upcoming section). Therefore there is no reason for clients not to fund their A&B marital trusts.

Because A&B trusts are revocable, they provide NO asset protection from creditors of the clients.

Conclusion

I know it is a strong statement, but EVERYONE with any amount of assets should have A&B marital/living/revocable trusts (or just a single trust if you are not married) to avoid probate and maximize the estate tax exemptions. It is just that simple. If your clients do not have A&B trusts, they are doing their heirs a tremendous disservice and eventually will make the federal and possibly state government very happy at their death.

Irrevocable Life Insurance Trusts (ILIT)

ILITs are a much-underutilized tool in the estate planning arena. Only about two high end clients out of ten will have an ILIT, which means a good portion of the other eight will mostly be underinsured due to the fact that 40% of the life insurance proceeds could go to the government via estate taxes at death.

Life Insurance

Do your clients have enough life insurance? For the younger clients, overall, I would say that the majority have too little life insurance in their estate plans. Clients need life insurance when they are young to protect the family in case of an early death of the breadwinner. Many younger clients have between $500,000-$1,000,000 in term life insurance for a term of 10-30 years.

Why would a non-insurance advisor want to help their clients with life insurance? First, most clients do not have the right kind of life insurance or are paying too much for the insurance they have. Second, it is easy to show a client a tangible benefit by saving them money on their life insurance premiums. After reading the educational module on life insurance every non-insurance advisor will understand why this needs to be addressed in any client's estate or financial plan.

The question you should pose to your younger clients is: Do you have enough life insurance so that, if you die in the near future, your spouse will not have to go back to work (if the spouse is a homemaker), or continue to live your current lifestyle (if also working); and will there be enough money to pay for your children's living and educational expenses until they get through college? Nearly 90% of the time, the client does not have enough life insurance to pay for those noble goals.

While the client will be dead and will not have to worry about what is left behind, most intend to take care of their families as if they had not died. That is not possible with $500,000-$1,000,000 worth of insurance.

How much is right for your clients? Without looking at a client questionnaire, it is tough to say exactly how much is needed, but any decent insurance agent (one whom you can trust) should be able to tell you what clients need, taking into account all the debts of the family and the needs ongoing after a premature death of the breadwinner. At a minimum, most younger clients will need at least 2 million dollars of life insurance. You will learn much more about the appropriate amount and kind of life insurance in the educational module on life insurance.

For older clients, they too are usually underinsured due to the fact that many clients with wealth over the age of 50 have estate tax problems. Those clients can either 1) gift assets away; 2) have their heirs pay 40% estate taxes on the assets above $5,250,000 in the estate, the client can purchase life insurance to pay for the estate taxes. For clients with estates over $10,000,000, it is easy to justify the purchase of 2-3 million dollars of death benefit for estate planning (assuming the estate will continue to grow prior to death).

Income tax free death benefit

As you are probably aware, life insurance death benefits pass to beneficiaries Income Tax Free. That is one of the wonderful things about life insurance. (Let's also not forget that any death benefit can pass to a spouse income and estate tax free). Unfortunately, unless a client is giving the entire death benefit to the spouse, there will be estate taxes due on life insurance death benefits unless the life insurance policy is owned by an **ILIT**.

Estate tax free death benefit

As indicated, death benefits will pass to a spouse income and estate tax free. That is why many people think that there is little need for an ILIT. However, ask yourself what happens if a spouse who lived after a client's death happened to die the next day, or the next year, or within five years. That is where good planning really pays off.

It is important for advisors to spell out for clients the problem of passing the entire death benefit to the living spouse due to the potential that the death benefit will be estate taxed at the second spouse's death. That living spouse many times will not be able to spend down the estate before he/she dies, and the life insurance benefit that passed to the living spouse will get zapped with estate taxes anyway. Careful budgeting is needed to determine how much, if any, of the death benefit should be given directly to the surviving spouse.

Many times the surviving spouse will only need a fraction of the death benefit because the rest of the estate is already several million dollars, of which hundreds of thousands are liquid IRA/401(k) money or stocks, which the spouse can live on until death.

It is preferable to set up an ILIT and have the death benefit poured into the ILIT at the death of the breadwinning client. The ILIT will, typically, have the children as the beneficiaries and have special language in it not to give the children the money until the second spouse dies (where the death benefit can be used to pay estate taxes, if needed). The special language of the trust will allow the trustee to provide for the well being of the surviving spouse, if needed, so that, even though the ultimate beneficiary may be the children, if the spouse needs money to keep up his/her lifestyle, the trustee can take money out of the ILIT to fund such needs.

With the special language, the client has accomplished all the goals of having the entire death benefit of the life policy pass to the children or a living benefit to the spouse while living.

ILIT has to own the policy

In order for the death benefit to pass income and estate tax free, the ILIT needs to be the owner of the policy and should also pay the premiums for the policy. Many times I will see that an ILIT is set up and is either not the owner of a policy or not paying the premiums of the policy.

The proper way to fund a policy in an ILIT is as follows:

1) Set up the ILIT;

2) Gift money to the ILIT for the first year's premium (and every year thereafter);

3) Have the ILIT set up a bank account;

4) Have the ILIT pay the premium on the policy it owns from the ILIT's own bank account. Funding a policy in an ILIT any other way is simply wrong.

Conclusion

ILITs are not necessarily needed for the younger client with a small estate (although keep in mind that, if a client has a 2-million-dollar life policy and if the client has any other assets that amount to $5,000,000, the estate is already over the cap where estate taxes will come into play (assuming the estate tax exemption in 2013 is $3,500,000 per person).

If your clients have an estate of more than $5,000,000 (usually closer to $7,000,000 and up, including any life insurance), then they should consider having an ILIT.

If your clients are 45 years and older with a large estate and they think they have enough life insurance, make sure they get their calculator out and see if they really have too little life insurance due to the fact that 35%-50% (depending on what percentage ends up being in 2013) of the life insurance could go to the government to pay estate taxes.

No one likes to pay for insurance, but it is vitally important to clients that they have not only the right amount of life insurance, but have the insurance owned by the right entity (which for many clients is an ILIT).

Dynasty Trusts

Dynasty Trusts merit a brief mention in this material.

If you ever heard a dynasty trust salesperson pitch this to a client, you would think it was the greatest tool ever invented. Most people, when they initially look at a dynasty trust do not understand that the trust is "irrevocable" and, as such, works great for clients who don't mind giving away their money.

Dynasty trusts are a great way to avoid estate taxes (although not generation skipping taxes), but the problem is that in order to get assets into a dynasty trust the client generally has to gift the property to the trust. This can create gift tax problems for the client who desires to gift to the trust more money than allowable in the lifetime gift tax exemption.

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In addition to the gift tax problems, there are income tax problems on the gains of investments in the trust. Dynasty trusts should only be funded with certain types of assets. The IRS taxes the income from these trusts very heavily (39.6%). As a result, the assets placed inside the dynasty trust must be tax-free, so as not to incur an annual tax bill. Non-dividend growth stocks, tax-free municipal bonds, and cash rich life insurance policies are suitable choices.

Advisors tout dynasty trusts as asset protection tools and a way to move appreciating assets out of the estate for estate tax purposes, but for the most part these are fairly limiting for most clients.

Divorce Protection

Have you ever had a friend or relative come into an inheritance, then hear the horror story about that friend or relative losing half of it to an ex-spouse in a divorce? It happens more than you would think.

Imagine that you are married and your last living parent passes away leaving you with $2,000,000 (real estate and stocks). You put the money in your marital bank account or put the real estate in your and your wife's name and then go on with life as normal. Then one year later your spouse decides to divorce you. (A similar scenario can play out if you die in the middle of obtaining a divorce).

What is the departing spouse entitled to?

The answer is, it depends on your state of residence; but if you have been married for more than 10 years, the chances are significant that your spouse is going to get half of everything you inherited. If that does not make you sick to your stomach, nothing will.

How do Clients Protect Inherited Assets in a Divorce?

Unfortunately, there is very little a client can do. The planning needs to come from the client's parents. Usually, parents will leave a fairly liquid estate (usually in the form of a death benefit from a life policy). Real estate and personal belongings are also given, but many times the estate is made up of a large life insurance policy. Either way, the best way to protect a client from losing inherited assets in a divorce is through the use of an **irrevocable trust**.

The client's parents can set up an irrevocable trust so that, when they die, their assets are all poured into it. The client may be the ultimate beneficiary of that trust; but during most of the client's life, the language of the trust will allow the trustee (usually a bank or trusted family advisor or friend) to dip into the

irrevocable trust for many different purposes (almost for whatever they feel like, as long as it is on the client's behalf).

The trust document could be written so that, if the client ever got divorced, none of the assets of the trust would be able to go to the spouse in the divorce or after. Many times a portion of the assets will be given outright to a client at a scheduled age, no matter if the client is divorced or not. For example, there might be language to give the client 25% of the assets at age 60, then 65, then 70, and, finally, at 75. The thinking behind this is that if client is still married at those ages, the chances of getting divorced (assuming the client has been married for a while) are much less likely.

The trustee would still, typically, have the ability at early ages to dip into the trust for purchases of items or outright cash distributions; but those would be at the discretion of the trustee as per the language of the trust.

Prenuptial Agreement

Many clients with significant wealth will use a prenuptial agreement to dictate exactly what each spouse is entitled to in the event of a divorce. Most of the time prenuptial agreements are used in second marriage situations where one of the spouses has already amassed a significant estate and the other has little or no estate. The spouse with significant wealth going into the second marriage typically desires to preserve the majority of the estate for his/her children from a prior marriage, and a prenuptial agreement is a nice way to accomplish that goal.

Prenuptial agreements are not an easy topic to discuss with a potential spouse; and because of the touchy nature of the subject, many times wealthy clients who really should have prenuptials do not. Hindsight is always 20-20; and if you have clients who are concerned that a spouse will be awarded more than they think is fair in a divorce, then they should seriously think about a prenuptial agreement prior to marriage (especially in the case of a second marriage).

If you have clients who are currently married and wish they had a prenuptial agreement, they can see if their spouse will sign a **post**nuptial agreement, which will work the same as a prenuptial agreement.

Generation Skipping Tax

The generation skipping tax (GST) is not a huge issue for most estate plans because most of the time the majority of the assets in an estate will pass, not directly to the grandchildren, but instead to the children who, in turn, might pass the wealth to the grandchildren. However, if you have client's estate that is

large enough, using a generation skip to pass wealth could save the grandchildren millions of dollars in estate taxes.

The IRS wants assets to flow through as many estates as possible (to collect revenue in the form of estate taxes), and so the system is set up to have assets pass to children (where it will be estate taxed) and then to grandchildren where assets will again be estate taxed. If assets were allowed to go directly to the grandchildren, then a whole level of estate taxes would be skipped where the government could lose literally millions of dollars in estate taxes just from one client's estate.

If a client tried to pass wealth **directly to the grandchildren** at death without the use of the GST **exemption**, the transfer would be **double taxed** both at the estate tax rate (40% in 2013 which is used when clients pass wealth to their children) and then at the flat GST rate of (40% in 2013). If you take advantage of your GST exemption, you can give upwards of $5.25 million (**per spouse**) to your grandchildren at death and have that money pass without the GST.

GST Exemptions

The exemption rates for the GST are as follows:

Thanks to the American Taxpayer Relief Act of 2012, the GST exemption is $5.25 million per spouse (indexed for inflation).

Year	Tax Rate	GST Tax Exemption
2013 and beyond	40%	$5,250,000

Your clients' estates will **still have to pay normal estate taxes** on money given to the grandchildren (although, if they gift less than the amounts per spouse listed above, they will avoid the double tax hit on the GST).

Why use a Generation Skip?

The main time a clients would use a generation skip (and, therefore, the GST exemption) is when they know that when their children die, they will have an estate tax problem. If that is the case, the client will avoid having their wealth doubly estate taxed at their death and then again at their children's death by using the GST exemption.

Let's go through a quick **example**. For this example, it will be assumed that the GST and estate tax will go back to level prior to President Bush's temporary tax cuts (which are now extended until the end of 2012).

Dr. Smith has a $12.25-million-dollar estate, one child (who is also a physician), and three grandchildren. When Dr. Smith dies (**assuming no living spouse**), $12.25 million will pass to his child; and the estate taxes due are $2.8 million ($12.25 million minus $5.25 million estate tax exemption) leaving the child with $9.45 million after estate taxes.

Dr. Smith's child practices medicine for 30 years and invested the $9.45 million wisely (now $15 million) **and** also created his own $5-million estate. When Dr. Smith's child dies, he now has a $20 million estate that will be taxed when giving it to his/her children. The $9.45 million (now $15 million) that was passed to Dr. Smith's child (where estate taxes were paid once when Dr. Smith died) **gets estate taxed again** when Dr. Smith's child passes that now $20 million to his children (Dr. Smith's grandchildren).

If Dr. Smith had used the $5.25 million dollar GST exemption, at least $5.25 million would have avoided being estate taxed again when Dr. Smith's child eventually passed that $5.25 million inheritance (which grew over time) to Dr. Smith's grandchildren. By using the GST exemption, Dr. Smith's grandchildren saved estate tax on $8.33 million ($5.25 million plus growth) in estate taxes at the death of their parents. That savings would equal $3.33 million.

Limits on the Dynasty

The GST is applied to dynasty trust by assuming that the trust's beneficiaries own the assets in the dynasty trust outright.

Generation Skipping taxes are an important topic for any client who has significant wealth. Due to the time constraints of this course, advisors will only learn the tip of the iceberg when learning how to help clients avoid GSTs. There will be a separate education module just covering GST, but due to the limited nature of the topic, GST does not merit more space in this core estate planning module.

Conclusion "Basic" Estate Planning

Many advisors know the majority of the information in this education module. While there most readers should have learned some new items, the material should mainly be used as a reminder that many current clients need help with their estate plans. Further and equally as important is that your competitor's clients most likely do not have their "basic" estate plans done correctly and competent and informed advisors can use these basic estate planning tools to cultivate a new client base.

For clients with large estates $10,000,000 and up, the material in the "Advanced" estate planning module should be very interesting reading and helpful when trying to provide the best advice possible to clients with large estate tax problems.

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