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Estate planning basics something everyone should be familiar with

THE BUZZ

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Next week marks Estate Planning Awareness Week. While many of my colleagues tease me that this was my invention, the initiative was adopted in 2008 to help the public understand what estate planning is and why it is such a critical component to financial wellness.

Time and again, I am surprised by how many clients do not have estate planning documents in place, and of those who do, many have not had them reviewed in decades. According to the National Association of Estate Planners & Councils, it is estimated that more than half of Americans do not have an up-to-date estate plan.

No client or attorney can avoid death and taxes, but estate planning does not need to be overwhelming. Estate planning can be explained through the following guiding principles:

- Minimize tax consequences (estate tax and income tax).
- Avoid the court system (probate, guardian estates and disabled guardians).
- Provide asset protection for beneficiaries.

Estate and income tax consequences

Based on the year in which you die, the government allows you to pass a certain amount of assets free of estate tax or exempt from taxation. Under the Tax Cuts and Jobs Act, President Donald Trump doubled the exemption from $5 million to $10 million (adjusted for inflation) through 2025, but it will revert in 2026 to $5 million (though adjusted annually for inflation for an estimated $6 million exemption). However, the Illinois estate tax exemption is $4 million per person (with no inflation adjustments).

Estate tax planning was historically the focus of proactive planning because the tax rates are egregious — anywhere from 28.5% to 50% when you combine the state and federal estate tax liabilities. With proper planning, these taxes can be minimized or avoided.

Ideally, a married couple with a properly structured estate plan should be able to pass $8 million and $22.8 million tax free at the federal and state levels, respectively, and no tax should be owed until the surviving spouse's death.

However, due to the Illinois estate tax exemption, in 2019, Illinois residents with outdated documents may be subject to a tax of $1,112,759 on the first spouse's death. As the federal exemption is adjusted annually for inflation and the state exemption stays at $4 million, the potential tax will continue to increase.

With exemptions so high, and income tax rates at 23.8%, the historical focus on estate tax minimization has shifted to income tax minimization. Namely, in situations where a couple is not concerned with estate taxes, the attorney can shift the focus of planning to help mitigate income tax liabilities for future generations. Revocable living trusts provide the flexibility to maximize estate and income tax planning.

Avoid the court system

Unlike the high estate tax exemptions, the threshold to avoid probate (the judicial process of administering an estate) is much lower. The families of decedents with assets valued at $100,000 or more titled in their individual names are required to open a probate estate.

Probate can be costly, time consuming and public. Additionally, if there are minor children, guardian estates need to be opened for each minor child, further draining inheritances with administrative and legal expenses.

Many clients try to avoid probate with strategic titling of assets which pass to specific beneficiaries by operation of law or transfer on death designations. However, these forms of ownership are unattractive and carry the following burdens:

- Are problematic if the parties die simultaneously.
- Fail to maximize tax planning.
- Provide no asset protection for beneficiaries.
- May mandate a guardian of the estates for minor children.

In contrast, if virtually all of a client's assets are titled in her living trust prior to death and beneficiary designations list the living trust, we can avoid the probate process and guardian estates.

Asset protection

While many are not faced with a current creditor concern, in today's litigation-crazed society I advise clients to live by my mother's adage, "Hope for the best and prepare for the worst." Trusts can provide phenomenal asset protection for beneficiaries to ensure inheritance is left to beneficiaries — not their creditors. Following are some of the benefits of trusts:

- They provide asset protection for beneficiaries from creditors, including future ex-spouses.
- They protect minor children from themselves.
- They ensure inherited retirement plans are asset protected.
- They maximize wealth transfer.

When assets are distributed outright and free of a trust (or when a beneficiary has rights of withdrawal upon reaching certain ages), the assets are reachable by creditors and included in the beneficiary's taxable gross estates.

In contrast, if assets remain in a trust, even if a beneficiary becomes his or her own trustee upon reaching a certain age, we can maximize asset protection and pass assets estate tax free from generation to generation.

For these reasons, clients are encouraged to have four documents as the foundation of their estate plans: pour-over will, revocable living trust, power of attorney for property and power of attorney for health care.

Then, as a client's estate approaches the taxable levels, we may recommend additional planning tools to further minimize estate tax consequences.

Pour-over will

When a client has a living trust as part of her estate plan, ironically the will plays a minor role. A pour-over will is a special kind of will which works in conjunction with a living trust and provides that any assets titled in the decedent's individual name will pour over into the decedent's trust at death.

This provision does not ensure the assets avoid probate, but rather that after the probate process, the assets will pour over into the decedent's living trust. To ensure assets avoid probate, clients must retitle assets into the name of their trusts prior to death.

Revocable living trust

As described above, a revocable living trust provides the most effective mechanism to maximize estate and income tax planning, avoid probate and provide asset protection for beneficiaries.

A living trust provides no asset protection during the grantor's lifetime, but upon death the living trust becomes irrevocable and assets can be passed "in trust" to the beneficiaries. It can provide for the creation of trusts which can be used to promote values to heirs (encourage education and philanthropy) and protect the inheritance from the reach of creditors, government (in the case of a special needs beneficiary), judgments or divorces.

In the event of the grantor's incapacity, guardianship or conservatorship proceedings are also avoided as the successor trustee comes into power in the event of disability or death.

Powers of attorney for property, health care

Everyone over the age of 18 is encouraged to have powers of attorney for property and health care. Clients with outdated powers of attorney for health care should make sure their existing one grants the agent access to medical records to make informed medical decisions in accordance with the Health Information Portability and Accountability Act. These are critical documents for clients and their adult children to have in place.

Don't be one of the 56% to have an outdated estate plan. Make your estate plan a priority for you and your loved ones and take control over the legacy you wish to leave.