Why you need an estate plan

Many people assume that estate planning is mainly about saving estate taxes. Consequently, they often don't bother putting together an estate plan because they assume that their estate is too small to be taxed. Yet estates often are more valuable than we realize.

Moreover, estate planning provides many benefits beyond minimizing estate taxes. The most important reason to design an estate plan stems from the reality that upon a person's death their worldly assets—whether they fill a modest apartment or a 50-room mansion—must, by law, be properly distributed. A properly done estate plan details which assets are distributed to whom. Without proper planning, a court could step in to determine their distribution in accordance with state law, which may not fit the wishes of the deceased.

Additional estate planning benefits include:

- Controlling assets before and after death
- Providing for the care of dependent children
- Minimizing the emotional and financial burden on their heirs
- Minimizing feuding among heirs over the estate
- Ensuring the continuation of a business
- Maximizing the amount available for charitable donations
- Minimizing or avoiding the cost and delay of probate
- Providing for a legacy of your values

Inventory estate's assets and your wishes

A good way to get started is to calculate your current net worth. Your net worth statement, sometimes called a balance sheet, lists the assets you own and the liabilities you owe. The total value of the assets minus your debts equals your net worth.

The inventory measures the current financial health of your estate and shows whether you have a potential tax problem that you need to address. But most important, reviewing your estate's assets (including your favorite easy chair and golf clubs) starts you on the road to deciding where and how you want those assets disbursed. What do you want your spouse, children, relatives or close friends to receive? Are they capable of managing it, or might a trust be necessary? Do you want to give some of it to charity? Do you want to gift during your lifetime? What do you want to do with your business—sell it or pass it to the next generation?

Once you have a clear idea of what you want done with your property, you can begin exploring, with the help of your CERTIFIED FINANCIAL PLANNER™ and other advisers, what tools and strategies can make that happen with the most efficiency at the least cost. It's also important that this planning be done in the context of your current overall financial circumstances.

The four fundamental estate planning tools

Regardless of the size of your current estate, you generally should have, as a minimum, four estate planning tools: a will, a durable power of attorney, a living will and a medical power of attorney.

A will

A will is a legal document that details where you want your estate's assets to go (after debts and taxes are paid) and who is going to oversee the execution of the will. It also may state who is to care for your minor children. Without a will, the laws of the state will determine what happens to your estate's property.

Keep in mind that a will does not supersede everything else in your estate plan. For example, if your will lists your wife to receive your entire estate, but your ex-wife is the primary beneficiary of your life insurance policy and retirement account, then your ex-wife would likely end up with those benefits.

Durable power of attorney

A power of attorney designates a representative, such as your spouse or adult child, to perform certain actions for you should you become ill, incapacitated or otherwise unable to manage your affairs. Without a power of attorney, the court will need to approve needed financial transactions.

A living will

A living will is an individual's written declaration of what life-sustaining medical treatments he or she will allow or not allow in the event they become incapacitated.

A medical durable power of attorney
This document authorizes a person to make medical decisions on your behalf, ideally to carry out what you've specified in your living will.

While you can save money by creating some of these legal documents on your own with software or standardized forms, most adults should have a competent estate planning attorney draft the documents. Otherwise, you risk legal problems, challenges or overlooked details that could derail your intentions and create a headache for your heirs.

Additional estate planning tools

You may also need to use additional estate planning tools depending on the size and complexity of your estate. These tools may be useful for reducing potential estate taxes, but they can also serve other purposes.

Trusts
Trusts are legal vehicles for managing assets for the benefit of the trust owner or a trust beneficiary, and are typically less vulnerable to legal challenges than wills. The major purpose of some trusts is to save estate taxes. The credit shelter or bypass trust, for example, is used to help couples avoid "wasting" the amount each person can exempt from federal estate taxes, and irrevocable life insurance trusts can keep life insurance assets from being subject to estate tax.

Of the over 50 trusts available, however, many serve other purposes, including:

- Managing money for a young, financially incompetent or troublesome heir

- Ensuring that a person's assets go to their children rather than the children from a surviving spouse's previous marriage
- Financially assisting a disabled child without disqualifying the child for government assistance
- Providing increased benefits for charity and income for the donor
- Protecting assets from creditors
- Reducing the cost and public exposure of probate

Ownership of assets
Who owns what assets in a family can have a significant impact on an estate plan. For example, most couples own property jointly, "with rights of survivorship." Upon the death of one spouse, the jointly owned property automatically passes directly to the surviving spouse, avoiding probate.

While this is an appropriate choice for many couples, it's not the best choice in all situations. For example, you may want some property separately owned so that it passes to the children from a previous marriage, or so that a spouse isn't liable for the other spouse's debts. Proper titling also can reduce the need for trusts.

Insurance
Insurance can serve several purposes in estate planning:

- Protect your estate's assets from catastrophic loss or lawsuits
- Serve as an asset passed on to heirs or charities
- Pay for estate taxes
- Provide an equitable share to heirs who won't run the family business
- Provide cash to co-owners in a small business to buy out the deceased's estate

The ownership of life insurance bears careful scrutiny for estate planning. Estate owners often mistakenly own large amounts of life insurance to help pay for estate taxes. Although the death benefits are not subject to income tax, they may be subject to estate tax. Consequently, the insurance benefits earmarked to pay estate taxes on other property end up themselves being taxed.

Less expensive tax-saving strategies

If estate taxes are an issue, keep in mind less expensive tax strategies than say a trust. For example, you can give away $11,000 (indexed for inflation) every year to each person you choose, free of gift tax ($22,000 as a couple). You also can pay the tuition bill or a medical bill for a favorite grandchild or niece free of gift tax, as long as you pay it directly to the institution. Contributing to a grandchild's 529 college savings plan is another way to effectively shift significant estate assets.

Business owners

Estate planning is essential to anyone who owns a business because typically the business is the largest asset in the owner's estate. Again, this is not just an estate tax issue.

Only four in ten family businesses survive after being transferred to the next generation. While estate taxes sometimes play a role in this failure, more often it is due to lack of good succession planning. The owner, for example, may fail to groom a qualified successor or may divide the business evenly among the heirs, causing control conflicts. Sometimes the best decision is to sell before death and not pass on the business.

Planning charitable giving

Donors can always simply give directly to their favorite charities, either before or after death. But “planned” giving through such vehicles as donor-advised funds or charitable remainder trusts allows better control of those donations, can increase the amount you’re able to give the charity while simultaneously reducing gift and estate taxes, and can even provide lifetime income for the donor.

Again, as with all aspects of estate planning, advanced planning is necessary in order to implement most of these available strategies.

Discuss your estate plan with family

The estate owner can dramatically smooth the passing of his or her assets by discussing the estate plan in advance with the heirs. Heirs, stressed by the loss of a loved one, frequently feel uncomfortable, even guilty, about receiving an inheritance. Good planning and prior discussion can relieve much of their anxiety about receiving and managing the inheritance.

Advanced discussion can also minimize feuding among the heirs over the distribution of the estate’s assets. An AARP study found that one in five people over the age of 50 have experienced family conflict concerning inheritance issues.

Explain to heirs why you’ve made certain decisions, especially if it isn’t a simple matter of dividing liquid assets such as cash and stock evenly among them. Who will run the family business? Who gets the vacation home? Who receives which heirlooms and memorabilia? Listen to their feedback and revise plans, if appropriate.

Explaining your living will and medical power of attorney can minimize inter-family conflicts over your medical treatment should you become terminally ill, as well as minimize family anxiety about your wishes.

Talk with anyone you ask to carry out your estate plan, such as the estate's executor, a guardian for your children and the agents for your powers of attorney. Be sure they are competent for the task, that they understand their duties and your wishes and that they are strong enough to carry them out should some family members object.

The most important letter you may ever write

A simple letter of instruction, written in conjunction with your will, not only will provide your immediate family with information they need, it also increases the likelihood your affairs will be handled as you wish.

The letter might describe funeral arrangements, relatives and financial advisers to contact, investment accounts, location of important papers and even a suggested obituary. When you complete your letter of instruction, inform someone close to you where it is located.

Keep organized financial records

Heirs frequently find nothing more frustrating during a time of grief than digging through disorganized and incomplete financial records. Maintaining good records—what assets you have, where they are located and how to get in touch with the appropriate financial advisers—can save your heirs immense headaches, reduce the chance of costly errors and ensure that all assets and debts are accounted for.

Take care to document the cost basis of your assets. This will become particularly important should the estate tax be replaced with a capital gains tax on assets passed to heirs.

Review your plan periodically

Review your estate plan at least annually—particularly such components as wills and trusts. Tax laws change, personal circumstances change and your net worth may increase or decrease, necessitating revisions to your plan.

Coordinate your estate plan with planner and attorney

While some CFP® professionals are qualified estate planning attorneys, most planners work with third-party attorneys. Both professionals need to work closely together because it's important that the estate plan and any accompanying legal documents work in tandem with other elements of your overall financial planning, such as investments, saving for retirement or putting children through college.