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ESTATE PLANNING TIPS FOR INDIVIDUALS

A Speech for CPAs to Deliver to General Audiences

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In 1789, Benjamin Franklin wrote in a letter an often-quoted phrase: "...in this world nothing is certain but death and taxes." These ten words neatly summarize the importance of estate planning.

Of course, Mr. Franklin could not have predicted in those days how closely related death and taxes would become over the years.

As life becomes more complex, so do the laws relating to inheritances. But when family members are mourning the loss of a loved one, the last thing they need is to be overwhelmed with concerns about finances. Timely and thorough estate planning can help to eliminate this unnecessary burden.

Today I will touch on six important areas: the meaning of estate planning. joint tenancy -- a common form of property ownership. life insurance. tax aspects of estate planning. wills. and lastly, trusts.

Estate planning involves the accumulation, conservation, and transfer of property for the benefit of family members and others while you are alive.
and, especially, after you are gone. The primary goal of estate planning is to provide for the welfare and happiness of your family, both immediately after your death and -- even more importantly -- over the long-term. A secondary goal of estate planning is to minimize taxes.

Estate planning is not a simple process. There may be a number of people to consider, such as the executor, surviving spouse, children, and possibly even dependent parents. To complicate matters even further, you may need to consider children from a previous marriage. For example, how can you ensure that your children from another marriage will be raised and provided for in the ways that you wish after you’re gone, especially if your spouse remarries and is influenced by a new spouse? In addition, there may be various properties to consider, such as insurance, pensions, securities, real estate, and business interests. And there may also be debts of both the deceased and the estate, as well as federal and state taxes.

As you can see, estate planning covers a broad range of topics and is rather complicated. During this discussion, we can only consider some
of the most important aspects. Let’s begin by examining a form of property ownership which is probably the most widely used: joint tenancy.

In joint tenancy, the surviving owner has a right of survivorship -- that means that he or she automatically assumes ownership of the deceased’s property at the moment of death. Joint tenancy is sometimes called the "poor man’s will." But don’t be fooled into thinking that joint tenancy eliminates the need for a will, thereby avoiding probate -- the legal process of proving that a will is valid. Wills are used in ways that joint tenancy doesn’t address, and although joint tenancy does override a will and is a probate-avoidance method, this form of shared ownership is not always desirable.

Transferring your property into joint ownership is irrevocable and cannot be undone without the consent of all joint owners. You may lose control over the assets in question. For example, joint tenants have the power to sell their half of the property, which might be in conflict with the intentions of the party who originally owned the property. Before
establishing joint ownership of your assets, you need to assess the soundness of your relationships with other prospective joint owners, as well as your need to retain control and flexibility.

Life insurance is another important aspect of estate planning. Between one-half and three-quarters of most estates is composed of life insurance. Life insurance can be used to cushion the blow that results from the loss of earnings of the deceased breadwinner. . .earnings which are critical in paying normal living expenses.

Your beneficiaries can use life insurance proceeds to pay for your funeral expenses, debts and income taxes; the debts, expenses and taxes of the estate; and inheritance taxes, if any. Even though you may have enough assets for survivors to meet various required payments, these assets may have sentimental value, or may not be liquid or readily available -- the classic case being real estate. Life insurance allows your beneficiaries to keep prized possessions, and may save them from making forced sales at reduced prices which, in a down market, could result in serious erosion of the estate.
You may want to consider purchasing inexpensive term life insurance. It could rate as a "best buy" among different types of insurance. However, avoid naming your estate as beneficiary. This will keep the proceeds out of probate and ensure prompt payment directly to your beneficiaries. Better yet, consider giving the ownership of the policy to someone other than yourself, even the beneficiary. The policy will still pay out upon your death, but the proceeds will not be considered part of your estate. There could be a gift tax based on the value of the policy at date of gift, but if so, this tax would generally be less than what the estate tax would be on the face value of the policy. I’ll discuss gift taxes further in a few minutes.

I urge you to work with a CPA and your insurance agent in dealing with these and other strategies regarding insurance as part of an estate plan.

Another way CPAs can help you in your estate planning efforts is to minimize the tax claims on your estate. Although secondary to human interest factors in estate planning, tax minimization should always be aggressively pursued. No one should pay more tax than the law requires.
Estate taxes is a vast subject, much too involved to go into in any detail in this talk. However, I will touch on a few basic tax aspects of estate planning.

The Internal Revenue Code requires an estate tax return when the gross estate has a value of $600,000 or more, whether or not there is any tax due. Tax rates are progressive: the minimum rate is 37%, the maximum rate is 55%, which applies to the portion of an estate over $3 million. These rates were in effect in 1992 and earlier years, but could be changed by Congress at any time, so check with your CPA.

In computing estate taxes, there are various deductions and credits allowed, including funeral expenses; administration expenses, such as fees of executors, attorneys, and accountants; debts of the deceased, including mortgages; bequests to a surviving spouse and charitable organizations; and credits, including the unified credit -- which I will explain in a moment -- and the credit for state death taxes.
You should be aware that all your property may be left to your spouse without estate tax liability. However, this exemption, known as the marital deduction, can be a tax trap that may only postpone the day of reckoning. If you leave everything to your spouse, he or she will pay no taxes when you die, but when your spouse passes away, the assets from both estates will be included in his or her estate. The result: your spouse’s estate could end up being taxed at a relatively high rate and beneficiaries would receive a smaller inheritance.

Through the use of a properly designed trust, the high rate applied to the surviving spouse’s estate can be avoided. In fact, no tax will be paid on either estate if the total value of the combined estates is not over $1.2 million and each spouse makes full use of the unified gift and estate tax credit of $192,800, which is the equivalent of an exemption of $600,000. In other words, the tax credit and the exemption are, in effect, the same thing. Ideally, the estates should be structured so that each is identical in size and, therefore, taxed at the same rate. If either estate were larger than $600,000, it could be subject to tax. In practice, however, it’s hard to structure the equality of the two estates because
some of the assets of the first to go may be needed by the surviving spouse. The latter’s larger estate could wind up over the exemption and be liable for tax. I will talk more about trusts in general, and this trust in particular, later.

Making gifts to relatives and friends during your life is another strategy for reducing estate taxes. I might add that this is a classic and very effective strategy. However, except in cases of relatively small estates, or where gift-giving takes place over a long period of time, making gifts will not result in a completely tax-free estate. An annual gift exclusion allows you to give $10,000 per year to each of an unlimited number of recipients, or up to $20,000 to each, if your spouse consents. Gifts over $10,000 require the filing of a gift tax return. However, generally no tax is paid, because the gift is offset by a portion of the unified gift and estate tax credit. My advice: Start gift-giving early and keep the values at or below the exclusion amounts to avoid using up some of your gift and estate tax credit.
I should also point out that many states assess estate and inheritance taxes. Nevada is the only state without either. In many states, the tax is a so-called "pick-up" death tax based on the federally taxable estate over $600,000. However, a credit is allowed for the state death tax on the federal return. Therefore, the total tax burden on the estate is no greater than if no tax was imposed by the state.

Moving on, we will now take up one of the most critical documents in estate planning: your will. Both your CPA and your attorney should work with you in formulating an estate plan which will ultimately be reflected in your will and, possibly, in the form of one or more of various types of trusts.

Almost every person of legal age -- that is, 18 years and older -- should have a will. The will ensures disposition of hard-earned assets in the manner you wish. If you die without a will, or what is known as intestate, state law will govern who gets what and when they will get it. This state-mandated distribution may be at odds with your wishes. Dying
intestate may also increase the tax burden for survivors and cause disagreements within your family.

Each spouse should have his or her own will. Joint wills should be avoided as there could be complications during probate. For instance, there could be questions about the rights of a surviving spouse to revoke the joint will and to transfer properties in a manner contrary to the original joint will.

Writing a will enables you to select the person you want to supervise your estate, that is, an executor. It also allows you to choose a guardian for your minor children. If you don’t select an executor and a guardian and name them in your will, the probate court will do it for you, and their choices may be very different from those you would have made. In addition, there would be unnecessary administration expenses. Court-appointees command fees; your selected persons would most likely waive their fees. These unnecessary expenses would eat away at your estate.
A will can also be used to leave instructions for the future management of investments or a family business, or for setting up a trust for children. You can also provide for special needs or personal desires. For instance, you may want to make special provisions for a disabled child or relative, make a donation to a charitable organization, or forgive a debt. Instructions regarding funeral arrangements are best left in a separate letter, rather than inserted in a will which might not be readily accessible.

When writing a will, pay attention to the tax consequences of every provision, for you as an individual taxpayer while alive, as well as for your estate and beneficiaries. Consider making bequests of percentages of your estate, so that if there are sharp changes in the values of properties, your original intent as to distributions will be preserved.

Generally, you may disinherit anyone you wish in a will. One notable exception is that in most states you can't disinherit your spouse. Disinheritances may be accomplished simply by omitting the name in question. However, in the case of relatives, it may be advisable to write
"I disinherit so-and-so." Otherwise, the disinherited relative may contest the omission in court.

Keep in mind that legal formalities are critical in establishing the validity of a will. Specific technical requirements of a valid will are set by state laws. Generally, the will should be typewritten and properly executed -- that is, signed, dated, and witnessed -- to establish its validity. In most states, the will must be signed in front of two witnesses; in a few states three witnesses are required. You should sign only the original copy of your will, and keep it in a safe place known to your spouse and executor. Furthermore, since it should be accessible on short notice, don’t put the will in a safe deposit box. In some states the law requires that a safe deposit box be sealed upon the death of the owner until released by tax authorities.

I recommend that you review your will regularly and make revisions as necessary. Generally, any changes in family composition, and any significant changes in types or amounts of wealth, indicate a need to review one’s will. Alterations should never be made on the face of a will,
since they would cast doubt on the validity of the instrument. Any amendments should be attached to the will in the form of a document called a codicil. Better yet, destroy the old will and replace it with a new one. The new will should contain the statement, "I revoke all previous wills."

In addition to a will, consider a prenuptial agreement which protects the interests of children from an earlier marriage. A portion of your estate will automatically pass to your surviving spouse if you don’t have such an agreement. You may also want to draw up two durable powers of attorney: one for health care and one for finances. These durable powers are essential; they delegate responsibilities to family members who reflect your outlook and desires with regard to health care and money management, should you suddenly become incapacitated and unable to make decisions for yourself. In effect, therefore, you would remain in control.

The naming of an executor, and a guardian for minor children, are vital components of a will that deserve close attention.
First, let’s talk about the responsibilities of the executor. The executor represents the estate and carries out the provisions of a will. The executor’s job is a big one and it is wise to choose this person carefully. You should select someone who has knowledge of your family situation, who is competent, trustworthy, loyal, and has the time -- and will take the time -- to do the job, and to do it right.

Among some of the tasks required of the executor are: notifying insurance companies and other entities of your death; collecting any money owed to you and paying any debts you owe; accounting for all receipts and disbursements going into and out of the estate; preparing a complete inventory of all assets; managing your assets during the period of administration; liquidating any assets that may be needed to pay debts and taxes; preparing and filing all individual and estate federal and state tax returns; and distributing property as stipulated in your will -- the last phase before closing out the estate.

Now let’s talk about guardians for minor children. If you have children under 18, it is imperative that you name a guardian in your will. If you
don’t, the probate court will appoint a person to raise your children. The court might also designate a second person to serve as the child’s property guardian, that is, to help the child deal with financial matters. On the other hand, you can name a guardian in your will to fill both roles. By the way, a judge who appoints a guardian doesn’t have to ask your children who they would prefer, although this may be done.

Take the time to explain the guardian’s role to your children and seek their opinions, if they are old enough. Try to select a guardian who would approach child-raising in ways acceptable to you -- ideally in ways which you yourself would follow. The guardian’s geographic location, religious beliefs, values, and standards are important deciding factors. Also, talk with prospective guardians and obtain the necessary consent. They must be aware of the serious nature and wide scope of their responsibilities and show an ability and willingness to meet them.

A person who can wear two hats, that is, serve both as a personal guardian and as a property guardian, will speed up the selection process. However, if your parental guardian can’t fill the property guardian role,
you will have to look for someone who shares your views on material wealth, and who is also astute in financial matters.

One final estate planning topic that we should at least touch on is trusts. Trusts can be crucial in achieving your estate planning goals. The trust is an arrangement under which a person who owns property puts it into a legal entity called a trust, and instructs an individual or organization to manage it for the benefit of another individual under certain terms and conditions. These parties are: the settlor, who is the creator or maker of the trust; the trustee, who is the manager; and of course, the beneficiary. Trusts set up during life are subject to gift tax rules; those set up after one dies are subject to estate tax rules.

There are several benefits to setting up trusts. First of all, trusts are essentially private, in contrast to a will which is a public record. Trusts also avoid probate, an expensive, time-consuming process. Lastly, trusts serve as an asset-protection tool, not only for the wealthy, but for families with modest estates which -- when insurance, pensions, and inflation are taken into account -- are larger, or will become larger, than they think.
Unfortunately, there is no provision in the tax law for upward adjustment of the $600,000 estate tax exemption, so the portion of family wealth actually or potentially affected by the estate tax tends to keep rising.

Either an *inter vivos* trust or a testamentary trust can be drawn up to manage assets for the benefit of various individuals, including the maker. The *inter vivos* trust becomes effective during the life of the creator; the testamentary becomes effective upon the death of the creator. For example, you might wish to have someone else manage your investments. Or, you might wish to set up an educational trust for children or relatives, or a so-called spendthrift trust which would provide financial support for someone without the risk that resources would be squandered. Or, you could establish a special needs trust for a disabled person in such a way that public assistance wouldn’t be cut off.

One of the most talked-about trusts these days is the popular revocable living trust. This type of trust has a lot going for it. The revocable living trust avoids probate and the related expense -- a big plus. It also permits the rapid distribution of estate assets upon the death of the creator, unlike
a probate estate. The creator of this trust and the manager are generally the same person. No separate books have to be kept for tax purposes because trust activity is reflected on the creator’s personal tax return. In addition, you -- as the creator -- can change or revoke this type of trust at any time.

A person deeply in debt would want to think twice, however, before setting up a revocable living trust. While probate establishes a deadline for creditor claims, this isn’t the case with a revocable living trust. Therefore, property in the trust could be under threat of a creditor’s claim for an extended period. A final point worth noting is that revocable living trusts do not confer income or estate tax savings on the creator. What they do offer is probate avoidance and privacy, and this is what makes revocable living trusts so attractive.

A marital life estate trust, also referred to as a bypass trust, can be set up to reduce estate taxes. I mentioned this trust when I talked about the way in which a couple with a combined estate of as much as $1.2 million could structure their different properties to avoid estate taxes. In a
marital life estate trust, the trust property of the first to die would bypass the estate of the second to die. This trust becomes irrevocable upon the death of the first to die.

There are other irrevocable trusts of various types which can result in large income tax savings, estate tax savings, or both. The catch is that such trusts require giving up a great deal of control over the property transferred into trust. Donors who retain too much control run the risk of a challenge by the IRS.

One widely used irrevocable living trust is the life insurance trust. This trust can be set up to provide for the surviving spouse and, subsequently, children. It works something like this: You make a gift to the trust of the insurance premiums, which may result in gift tax consequences. The trust uses the gift premiums to purchase an insurance policy which is owned by the trust. Upon your death, the face amount of the policy is paid over to the trust. The proceeds are not counted as part of your taxable estate, as they would be if the beneficiary were someone other than the trust or your spouse. The income on the proceeds can be paid
to the surviving spouse for life. Upon his or her death, the principal can be transferred to children, without tax liability to anyone. But be reminded that irrevocable means just that -- once you make the gift premiums, you can't get your money back.

Another example of an irrevocable living trust is one involving real estate. Leisure-time property could, for example, be deeded to an irrevocable trust. If properly drawn, use of the property would not be impaired. The property transferred would be subject to gift tax at its then current value. However, when the maker dies, the vacation property would be taken into the estate at the date-of-gift value, not the presumably much higher appreciated value at the time of death. The estate tax savings could be substantial.

However, before setting up a trust, I would strongly recommend that you consult a CPA and an attorney, as the rules are complex.
I’d like to wrap up by stressing that estate planning, if effectively carried out in consultation with your CPA and attorney, will allow you to have more control over what happens to your assets after you die. More importantly, effective estate planning tends to ensure a happier and more secure future for your family. Your family will have the benefit of more of the wealth you worked hard to create during your lifetime. You can also reduce the risk that some of your wealth may be needlessly eroded by various expenses, including taxes. And remember, while you can’t take it with you, you can at least preserve it for your loved ones.
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