Estate planning tips for individuals: A Speech for CPAs to deliver to general audiences

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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 the often-quoted saying: "in this world nothing is certain but death and taxes." These ten words neatly summarize the importance of estate planning.

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

The laws relating to inheritance are becoming more and more complex. 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 eliminate this unnecessary burden.

Today, I’ll 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 trusts. (OPTIONAL: I will throw out quite a bit of information, but don’t worry about taking notes. After my
talk, I’ll give you a brochure* that summarizes some of the more important points you should know about estate planning.)

Estate planning involves the accumulation, conservation, and transfer of property for the benefit of family members and others for whom you want to provide. The primary goal of estate planning is to ensure the financial security 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 other beneficiaries. To complicate matters even further, you may need to consider children from a previous marriage or even dependent parents. For example, how can you ensure that your children from another marriage will be raised and provided for the way you want after you’re

* To order the brochure, "Estate Planning: Protecting Your Family," call the AICPA Order Department at 1-800-862-4272 and request product # 890824. Cost is $24/100 brochures.
gone, especially if your spouse remarries and is influenced by a new spouse? In addition, there may be various assets to consider, such as insurance, pensions, securities, real estate, and business interests. Also, there may be debts that are owed by both you and your estate, as well as federal and state taxes.

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

If you heard the term "joint tenancy" out of context, you might think of something you don’t want your teenagers doing before they’re married. But, it’s actually a technical term in real estate law to describe common ownership where the owners hold a right of survivorship -- that means one joint tenant automatically assumes ownership of the property at the moment of the death of the other. 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 -- that is, 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 without the consent of all joint owners. Therefore, you may lose control over the assets in question. For example, a joint tenant has the power to sell his or her interest in 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 the other prospective joint owners, as well as your need to retain control over the property.

Life insurance is another important aspect of estate planning. One-half to three-quarters of most estate wealth is comprised of life insurance policies. Life insurance can be used to cushion the blow that results from the loss of earnings of a deceased breadwinner -- earnings that are usually critical in paying normal living expenses.
Beneficiaries can use life insurance proceeds to pay for the decedent’s funeral expenses, debts and income taxes; the estate’s debts, expenses and taxes; and inheritance taxes, if any. Even though you may have sufficient assets for survivors to meet various required payments, these assets may not be liquid or readily available, or may have sentimental value -- 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.

When buying insurance, avoid naming your estate as beneficiary to 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 generally would be less than what the estate tax would be on the face value of the policy. I’ll discuss more about gift taxes in a few minutes.
To plan these and other insurance strategies as part of an estate plan, it’s helpful to consult a CPA and an insurance agent.

Another way a CPA can help you in your estate-planning efforts is to minimize the tax claims on your estate. Although secondary to human factors in estate planning, minimizing taxes can yield a substantial savings and should be part of the planning process. Estate tax is a vast subject, much too involved to go into in any detail in this talk. However, I’ll 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 effective minimum rate is 37 percent, the maximum rate is 55 percent, which applies to the portion of a taxable estate over $3 million. Of course, these rates 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 tax credit -- which I'll 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 "bypass trust," the high tax rate applied to a 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 less than $1.2 million and each spouse makes full use of the unified 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 spouse's estate 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 die may be needed by the surviving spouse. The latter's larger estate could exceed the exemption and be liable for tax. I'll talk more about trusts in general, and bypass trusts in particular, later.

Giving a gift to a relative or friend will get you a gift in return from Uncle Sam -- in the form of tax savings. Gifts are, in fact, a classic and very effective strategy for lowering your tax burden. 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 if your spouse joins in the gift. Gifts over $10,000 require the filing of a gift-tax return.
Generally, however, no tax is paid, because the gift is offset by a portion of the unified tax credit. My advice: Start gift-giving early and keep the values at or below the annual exclusion amounts to avoid using up some of your unified tax credit.

I also should 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" of the federal death tax based on a taxable estate of over $600,000. However, a credit is allowed on the federal return for taxes owed to the state at your death. Therefore, the total tax burden on the estate is no greater than the federal estate tax.

Now let's move on to discuss one of the most critical documents in estate planning: your will. Both a CPA and an attorney should work with you in formulating an estate plan that ultimately will be reflected in your will and, possibly, in one or more various types of trusts.

Almost every person of legal age -- that is, 18 years or older -- should have a will. The will ensures disposition of your 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 also may 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 may 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 name an executor or guardian in your will, the probate court will do it for you, and its choices may be very different from those you would have made. In addition, there could be unnecessary administrative expenses. Court appointees command fees;
your selected persons may waive their fees. These unnecessary expenses would eat away at your estate.

A will also can be used to leave instructions for the future management of investments or a family business, or for setting up a trust for children. You also can 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 actually 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 law. 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 necessitate reviewing one's will. Alterations should never be made on the face of a will, since that would cast doubt on the validity of the instrument. Amendments should be attached to the will in the form of a formally executed document called a "codicil." Better yet, replace the old will with a new will, and then destroy the old one. The new will should contain the statement, "I revoke all previous wills."

In addition to a will, consider a prenuptial agreement, which is a contract entered into before a marriage to establish the property rights of the spouses. These agreements are especially useful in second marriages to protect the interests of children from an earlier marriage. Without an agreement, a portion of your estate automatically will pass to your surviving spouse.

You also may 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 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 the will. The executor’s job is a big one and it’s wise to choose this person carefully. You should select someone who has knowledge of your family situation, who is competent, trustworthy, loyal, and who has the time -- and will take the time -- to do the job, and do it right.

Among some of the tasks required of the executor are: notifying insurance companies 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 -- both 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’s 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. And, while a judge who appoints a guardian may ask the children who they’d prefer, he or she is not required to do so by law.

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’ll have to look for someone who shares your fiscal views and who also is astute in financial matters.

You should take the time to discuss guardianship with your children. Explain the guardian’s role to them and, if they are old enough, seek their
opinions. Try to select a guardian who would approach child-raising in ways acceptable to you -- ideally, in ways that you yourself would follow. Therefore, the guardian’s geographic location, religious beliefs, values, and standards can be 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.

Trusts are one final estate-planning topic that we should at least touch on. The "trust" is a legal entity into which a person puts property to be managed by an individual or organization for the benefit of another individual. The parties involved in a trust arrangement 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 one’s life, known as _inter vivos_ trusts, are subject to gift-tax rules; those set up after one dies, or testamentary trusts, 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. Finally, 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.

Trusts, whether *inter vivos* or testamentary, 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 trust becomes effective upon the death of the creator. Why would you set up a trust for yourself, you may ask. Well, 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 provides 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 can permit the rapid distribution of trust assets upon the death of the creator, unlike assets that pass through the probate estate. The creator of this trust and the trustee 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, there’s no deadline for 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 these attributes are 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 that 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 amount 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. 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, remember, 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. Your leisure-time property could, for example, be deeded to an irrevocable trust. If the trust is properly drawn, your use of the property would not be impaired. The property transferred would be subject to gift tax at its then-current value. However, when you die, the vacation property would be taken into your estate at the date-of-gift value, rather than 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’d strongly recommend that you consult a CPA and an attorney, as the rules are very complex.

In closing, I’d like to stress 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, who will have the benefit of more of the wealth you worked hard to create during your lifetime. You also can reduce the risk that some of your wealth be needlessly eroded by various expenses, including taxes. And remember, while you can’t take it with you, you can at least keep it for your loved ones.

Thank you. Now I’ll be happy to take your questions.
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