Amboy's In-Retirement Learning Center
ESTATE PLANNING

Table of Contents

Introduction to Estate Planning

What is estate planning?

Simply stated, estate planning is a method for determining how to distribute your property during your life and at your death. It is the process of developing and implementing a master plan that facilitates the distribution of your property after your death and according to your goals and objectives.

At your death, you leave behind the people that you love and all your worldly goods. Without advance planning, you have no say about who gets what, and more of your property may go to others, like the federal government, instead of your loved ones. If you care about (1) how and to whom your property is distributed, and (2) ensuring that your property is preserved for your loved ones, you need to know more about estate planning.

As a process, estate planning requires a little effort on your part. First, you'll want to come to terms with dying, at least to a degree that you can deal with the necessary planning. Understandably, your death can be a very uncomfortable subject, but unfortunately, the discussions in this area are full of references to your death, so it really can't be avoided. Some statements may seem too businesslike and unfeeling, but tiptoeing around the subject of dying will only make the planning process more difficult. You will understand the process more easily and implement a more successful master plan if you approach it in a straightforward manner.

Who needs estate planning?

Not just for the wealthy

Estate planning may be important to individuals with a wide range of financial situations. In fact, it may be more important if you have a smaller estate because the final expenses will have a much greater impact on your estate. Wasting even a single asset may cause your loved ones to suffer from a lack of financial resources.

Your master plan can consist of strategies that are simple and inexpensive to implement (e.g., a will or life insurance). If your estate is larger, the estate planning process can be more complex and expensive.

Implementing most strategies will probably require you to hire professional help of some kind, an attorney, an accountant, a trust officer, or an insurance agent, for example. If your estate is large or complex, you should consult with an estate planning expert such as a tax attorney or financial planner for advice before the implementation stage.

In deciding on your course of action, you should always consider whether the benefit of the strategy outweighs the cost of its implementation.

May be especially needed under certain circumstances

You may need to plan your estate especially if:

- Your estate is valued at more than the federal gift and estate tax applicable exclusion amount or your state's death tax exclusion amount
- Your income tax bracket is in excess of 10 percent
- You have children who are minors or who have special needs
- Your spouse is uncomfortable with or incapable of handling financial matters
- You're a business owner
- You have property in more than one state
- You intend to contribute to charity
- You have special property, such as artwork or collectibles
- You have strong feelings about health-care decisions
- You have privacy concerns or want to avoid probate

How to do it

Designing a plan is a process that is unique to each estate owner. Don't be intimidated or overwhelmed at the prospect. Even the most complex plan can be achieved if you proceed step by step. Remember, the peace of mind that comes with developing a successful estate plan is worth the time, trouble, and expense.

Understand your particular circumstances

Begin the estate planning process by understanding your particular circumstances, such as your age, health, wealth, etc.

Understand the factors that will affect your estate

You will also need to have some understanding of the factors that may affect the distribution of your estate, such as taxes, probate, liquidity, and incapacity.

Clarify your goals and objectives

When your particular circumstances and the factors that may affect your estate are clear, your goals and objectives should come into focus.

Understand the strategies that are available

With these goals and objectives now clear, you can begin to consider the different estate planning strategies that are available to you.

Seek professional help

Seeking professional help (an attorney or financial advisor) will help you understand the strategies that are available and formulate and implement your master plan.

Formulate and implement a plan

Finally, after following these steps, you can formulate and implement a plan that works for you. Here are a few basic tips: (1) make sure you understand your plan, (2) rely on people you trust, and (3) keep your documents and information organized and within easy reach.

Perform periodic reviews

When you have implemented your master plan, be sure to perform a periodic review and, if necessary, make revisions that reflect any changing circumstances and tax laws.

How do you begin?

There are many estate planning strategies, including some that are implemented inter vivos (during life), such as making gifts, and others post-mortem (after death), such as disclaimers. Before you choose which strategies are right for you, you need to understand your particular circumstances.

Gather and analyze the facts

Understanding your particular circumstances results from gathering and analyzing the facts. The following questions may help you to accomplish this. If they are not easy to answer, you may have to make some estimates based on reasonable assumptions and expectations.

Information regarding your financial condition

- What is your current income?
- What is your income likely to be in the future?
- How much do you spend each year?

- What are your expenses likely to be in the future?
- What are your current assets and debts?
- Are your assets currently owned solely or jointly?
- What estate planning strategies have you already implemented?

Family information

- Who are the family members you intend to benefit?
- What are the needs of each family member?

What other factors need to be considered?

Decide what your goals and objectives are in light of your particular circumstances and in light of the factors that may affect your estate. The primary factors that may affect your estate are your beneficiaries, taxes, probate, liquidity, and incapacity.

Taxes

One of the largest potential expenses your estate may have to pay is taxes, which may include federal transfer taxes, state death taxes, and federal income taxes.

Federal transfer taxes — The federal transfer taxes include (1) the federal gift tax and estate tax and (2) the federal generation-skipping transfer (GST) tax.

- Federal gift tax — Gift tax is imposed on property you transfer to others while you are living. You need a basic understanding of how the gift tax system works to minimize gift tax liability. Under the gift tax system, in 2018 you are allowed a $11,200,000 lifetime applicable exclusion amount that reduces your gift and estate tax liability (any (basic) applicable exclusion amount you use during life effectively reduces the amount that will be available at your death). Also, you are currently allowed to give $15,000 per donee gift tax free under the annual gift tax exclusion (the annual gift tax exclusion is indexed for inflation, so this amount may change in future years). Further, certain other types of transfers can be made gift tax free. You need to understand what these types of transfer are and how they work to take full advantage of them.
- Federal estate tax — Generally speaking, estate tax is imposed on property you transfer to others at the time of your death. You need a basic understanding of how the estate tax system works for several reasons:
  - Saving your property for your beneficiaries — Estate tax rates could reach as high as 40 percent in 2018, which means that a large chunk of your estate may go to the federal government instead of your beneficiaries. If you want to preserve your estate for your beneficiaries, you'll need to know how to minimize estate tax with respect to your property.
  - Reducing estate tax liability — Under the estate tax system, you are allowed an applicable exclusion amount that reduces your estate tax liability. Also, there are exclusions, deductions, and other credits available that allow you to pass a certain amount of your estate tax free. You need to understand what these exclusions, deductions, and credits are and how they work to take full advantage of them.
  - Providing for the payment of estate tax — Generally, estate tax must be paid within nine months after your death. To avoid depriving your beneficiaries of what you intend for them to receive, you should provide that specific and sufficient assets be set aside and used for this purpose. In addition, these assets should be sufficiently liquid to pay these expenses when they are due.
  - Planning for estate tax expense — Although calculating estate tax can be complex, you should estimate what the amount of your estate tax may be (if any), so that you can arrange to replace that wealth.
- GST tax — Another federal transfer you need to understand is the federal generation-skipping transfer (GST) tax. The GST tax is imposed on property you transfer to an individual who is two or more generations below you (e.g., a grandchild or great-nephew). Not surprisingly, the IRS wants to levy a tax on property as it is passed from generation to generation at each and every level. The purpose of the GST tax is to keep individuals from avoiding estate tax by skipping an intermediate generation. A flat tax rate equal to the highest estate tax then in effect is imposed on every generation-skipping transfer you make over a certain amount. Currently, some states also impose their own GST tax. Check with an attorney or your state to find out what may be subject to your state's GST tax, and how and when to file a state GST tax return.

State death taxes — States also impose their own death taxes. You should be aware of what the death tax laws are in your state and how they may affect your estate. There are three types of state death taxes: (1) estate tax, (2) inheritance tax, and (3) credit estate tax (also called a sponge tax or pickup tax). Some states also impose their own gift tax and/or generation skipping transfer tax.

- Estate tax — State estate tax is imposed on property you transfer to others at your death, much like federal estate tax. The state estate tax calculation for most states is similar to the federal calculation.
- Inheritance tax — Unlike estate tax, the inheritance tax is imposed on your beneficiary's right to receive your property. Tax is due on each beneficiary's share of your estate. Beneficiaries are grouped into classes (generally based upon their familial relationship to you) and are taxed accordingly. Although inheritance tax is due on each heir's share of your estate, it's your personal representative who writes the check from your estate to pay it.
- Credit estate tax — Some states impose a credit estate tax (also referred to as a sponge tax or pickup tax).

Tip: *Most states that imposed a credit estate tax have "decoupled" from the federal system (i.e., they're imposing some form of stand-alone estate tax.)*

Tip: *The federal system allows a deduction for state death taxes for the estates of persons dying in 2005 and later. Prior to 2005, a credit was available.*

Federal income taxes — In the estate planning context, you should be aware of three federal income tax considerations:

1. Income taxation of trusts — If your estate plan includes the use of a trust, you need to know that a trust may be an income tax-paying entity. The trustee may be required to file an annual return and pay income taxes on trust income.
2. Decedent's final income tax return — Your personal representative or surviving spouse has the duty of filing your last income tax return that covers the tax year ending on the date of your death.
3. Income taxation of your estate — Your estate is considered a separate income taxpaying entity. Your personal representative must file and pay income taxes on any income your estate receives (e.g., interest from bonds, or dividends from stock).

Probate

Probate is the court-supervised process of proving, allowing, and administering your will. The probate process can be time-consuming, expensive, and open to public scrutiny. Avoiding probate may be one of your most important goals. To develop a successful avoidance strategy, you'll need to understand how the probate process works, how to estimate probate costs, and what is subject to probate.

Liquidity

Estate liquidity refers to the ability of your estate to pay taxes and other costs that arise after your death from cash and cash alternatives. If your property is mostly nonliquid (e.g., real estate, business interests), your estate may be forced to sell assets to meet its obligations as they become due. This could result in an economic loss, or your family selling assets that you intended for them to keep. Therefore, planning for estate liquidity should be one of your most important estate planning objectives.

Incapacity

Planning for incapacity is a vital yet often overlooked aspect of estate planning. Who will manage your property for you when you can no longer handle these responsibilities? You need to ask and answer this question because the consequences of being unprepared may have a devastating effect on your estate and loved ones. You should include plans for incapacity as a part of your overall estate plan.

What are your goals and objectives?

Your goals and objectives are personal, but you can't formulate a successful plan without a clear and precise understanding of what they are. They can be based on your particular circumstances and the factors that may affect your estate, as discussed earlier, but your feelings and desires are just as important. The following are some goals and objectives you might consider:

- Provide financial security for your family
- Ensure that your property is preserved and passed on to your beneficiaries
- Avoid disputes among family members, business owners, or with third parties (such as the IRS)
- Provide for your children's or grandchildren's education
- Provide for your favorite charity
- Maintain control over or ensure the competent management of your property in case of incapacity

- Minimize estate taxes and other costs
- Avoid probate
- Provide adequate liquidity for the settlement of your estate
- Transfer ownership of your business to your beneficiaries

What are estate planning strategies?

An estate planning strategy is any method that facilitates the distribution of your assets and the settlement of your estate according to your wishes. There are several estate planning strategies available to you.

Intestate succession

Intestate succession is a strategy by default and is a means of transferring your property to your heirs if you have failed to make other plans such as a will or trust. State law controls how and to whom your property is distributed, who administers your estate, and who takes care of your minor children. Without directions, your opinions and feelings are not considered. Indeed, one of your primary goals in planning your estate may be to avoid intestate succession.

Last will and testament

A will is a legal document that lets you state how you want your property distributed after you die, who shall administer your estate, and who will care for your minor children. This is probably the most important tool available to you. Anyone with property or minor children should have a will.

Will substitutes

A will substitute, for example, Totten Trust and payable on death bank accounts, allows you to designate a beneficiary of certain property that will automatically pass to that beneficiary after you die and avoids passing through probate.

Trusts

A trust is a separate legal entity that holds your assets that are then used for the benefit of one or more people (e.g., you, your spouse, or your children). There are different types of trusts, each serving a different purpose, and include marital trusts and charitable trusts. You will need an attorney to create a trust.

Joint ownership

Joint ownership is holding property in concert with one or more persons or entities. There are different types of joint ownership, such as tenancy in common and community property, each with different legal definitions, requirements, and consequences.

Life insurance

Life insurance is a contract under which proceeds are paid to a designated beneficiary at your death. Life insurance plays a part in most estate plans.

Gifts

A gift is a transfer of property, not a bona fide sale, that you make during your life to family, friends, or charity. Making gifts can be personally gratifying as well as an effective estate planning tool.

Tax exclusions, deductions, and credits

There are several important estate planning tools you can use that are offered by the federal government. These include the annual gift tax exclusion, the applicable exclusion amount, the unlimited marital deduction, split gifts, and the charitable deduction.

Estate Planning Checklist

General information	Yes	No	N/A
1. Has relevant personal information been gathered? • Personal details • Family details • Current advisory team • Goals and expectations	❑	❑	❑
2. Has financial situation been assessed? • Assets • Liabilities • Life insurance policies • Other insurance coverage • Income • Expenses	❑	❑	❑
3. Have current documents been reviewed? • Will • Trust documents • Power of attorneys • Medical directives • Insurance policies • Buy-sell agreements • Deeds, leases, mortgages, and land contracts • Guardian nominations • Separation/divorce agreements • Tax returns	❑	❑	❑
4. Have funeral arrangements been made?	❑	❑	❑
Notes:			

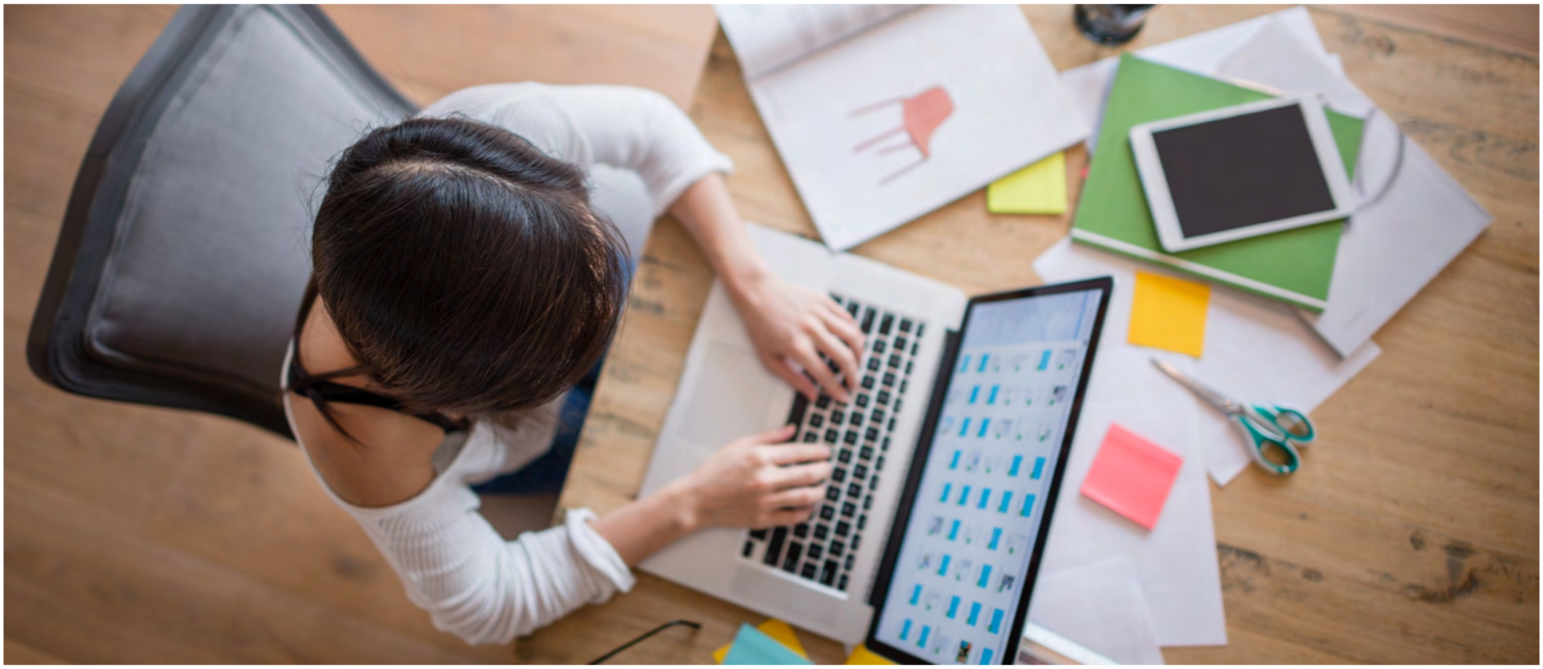
Basics	Yes	No	N/A
1. Is there currently a valid will?	❑	❑	❑
2. If yes, does will reflect current goals and objectives?	❑	❑	❑
3. Does choice of executor remain appropriate?	❑	❑	❑
4. Has durable power of attorney been executed?	❑	❑	❑
5. Have medical directives been executed?	❑	❑	❑
6. Have beneficiary designations for retirement plans and life insurance policies been reviewed?	❑	❑	❑
7. Has impact of probate been considered?	❑	❑	❑

Notes:			
Trusts	**Yes**	**No**	**N/A**
1. Is the use of a living trust appropriate?	❑	❑	❑
2. Is the use of a testamentary trust appropriate?	❑	❑	❑
3. Is the use of an irrevocable life insurance trust appropriate?	❑	❑	❑
4. Do existing trusts, if any, continue to meet overall objectives?	❑	❑	❑
Notes:			
Estate tax	**Yes**	**No**	**N/A**
1. Has estate plan been reviewed due to changing tax laws?	❑	❑	❑
2. Has impact of estate tax been evaluated?	❑	❑	❑
3. Have options to minimize estate tax been explored? • Lifetime gifting • Full use of basic (applicable) exclusion amount and marital deduction • Qualified terminable interest property (QTIP) elections • Qualified domestic trust (QDT) for noncitizen spouse • Charitable giving • Grantor retained trusts • Family limited partnership (FLP)/limited liability company (LLC)	❑	❑	❑
Notes:			
Lifetime gifting	**Yes**	**No**	**N/A**
1. Have gifts been made?	❑	❑	❑
2. Has a lifetime gifting strategy been implemented?	❑	❑	❑
3. Are gift tax consequences understood?	❑	❑	❑
4. Has consideration been given to types of property suitable for gifting?	❑	❑	❑

5. Is valuation discount planning understood?	❑	❑	❑
Notes:			
Charitable intentions	**Yes**	**No**	**N/A**
1. Have charitable gifts or bequests been planned?	❑	❑	❑
2. Is a charitable trust appropriate? • Charitable lead trust • Charitable remainder trust • Pooled income fund • Private foundation • Donor-advised fund	❑	❑	❑
3. Is a charitable gift annuity appropriate?	❑	❑	❑
4. Is the charitable gift of a remainder interest in a home or farm appropriate?	❑	❑	❑
Notes:			
Life insurance issues	**Yes**	**No**	**N/A**
1. Have liquidity needs of estate at death been evaluated?	❑	❑	❑
2. Is current life insurance coverage appropriate?	❑	❑	❑
3. Have steps been taken to keep life insurance proceeds out of taxable estate? • Policy ownership • Irrevocable life insurance trust	❑	❑	❑
4. Have beneficiary choices been evaluated in light of overall estate plan?	❑	❑	❑
Notes:			
Business interests	**Yes**	**No**	**N/A**

1. Have provisions been made to transfer business interest? • Buy-sell agreement and necessary funding • Sell business • Transfer business with lifetime gifts • Key person buyout	❑	❑	❑
2. Is liquidation an option?	❑	❑	❑
Notes:			

Life Insurance and Estate Planning



Life insurance has come a long way since the days when it was known as burial insurance and used mainly to pay for funeral expenses. Today, life insurance is a crucial part of many estate plans. You can use it to leave much-needed income to your survivors, provide for your children's education, pay off your mortgage, and simplify the transfer of assets. Life insurance can also be used to replace wealth lost due to the expenses and taxes that may follow your death, and to make gifts to charity at relatively little cost to you.

To illustrate how life insurance can help you plan your estate wisely, let's compare what happened upon the death of two friends: Frank, who bought life insurance, and Dave, who did not. (Please note that these illustrations are hypothetical.)

Life insurance can protect your survivors financially by replacing your lost income

Frank bought life insurance to help ensure that his survivors wouldn't suffer financially when he died. When Frank died and his paycheck stopped coming in, his family had enough money to maintain their lifestyle and live comfortably for years to come.

And since Frank's life insurance proceeds were available very quickly, his family had cash to meet their short-term financial needs. Life insurance proceeds left to a named beneficiary don't pass through the process of probate, so Frank's family didn't have to wait until his estate was settled to get the money they needed to pay bills.

But Dave didn't buy life insurance, so his family wasn't so lucky. Even though Dave left his assets to his family in his will, those assets couldn't be distributed until after the probate of his estate was complete. Since probate typically takes six months or longer, Dave's survivors had none of the financial flexibility that a life insurance policy would have provided in the difficult time following his death.

Life insurance can replace wealth that is lost due to expenses and taxes

Frank planned ahead and bought enough life insurance to cover the potential costs of settling his estate, including taxes, fees, and other debts that his estate would have to pay. By comparison, these expenses took a big bite out of Dave's estate, which had to sell valuable assets to pay the taxes and expenses that arose as a result of his death.

Life insurance lets you give to charity, while your estate enjoys an estate tax deduction

Using life insurance, Frank was able to leave a substantial gift to his favorite charity. Since gifts to charity are estate tax deductible, this gift was not subject to estate taxes when he died. Dave always dreamed of leaving money to his alma mater, but his family couldn't afford to give any money away when he died.

Life insurance won't increase estate taxes — if you plan ahead

Before buying life insurance, Frank talked to his attorney about the potential tax consequences. Frank's attorney told him that if his estate was large enough, it could be subject to federal and state estate taxes, depending on the applicable law at the time of his death. Frank and his attorney put a plan in place that would allow Frank's survivors to use his life insurance policy to help pay for some of the potential estate taxes that might be owed at his death.

Be like Frank, not like Dave

Throughout his life, Dave worked hard to support his family. Frank did, too, but went one step further — he bought life insurance to protect his family after his death. Here's how you can be like Frank:

- Use life insurance to ensure that your family has access to cash to help them meet both their short-term and long-term financial needs
- Plan ahead — buy enough life insurance to cover the potential costs of settling your estate and to ensure that the assets you leave to your survivors aren't less than you intended
- Consider using life insurance to give to charity
- Consult an experienced attorney about income and estate tax consequences before purchasing life insurance

Medicaid and Nursing Home Care

As you enter your 60s and 70s, health may become more of an issue than it once was, and your thoughts may turn to the future. Who will take care of you when you can no longer care for yourself? If you must enter a nursing home, how will you pay for it? By learning as much as you can about Medicaid right now and planning appropriately, you may be able to resolve these issues and create a more secure future.

Nursing homes provide different levels of long-term care

You may need to enter a nursing home if you become physically or mentally incapacitated and can no longer care for yourself properly. If the services of an in-home caregiver are inadequate or unavailable, or if you require around-the-clock care, entry into a nursing home on a long-term basis may be your only option.

A nursing home is a state-licensed facility that may provide skilled nursing care, intermediate care, and/or custodial care.

- Skilled care: This around-the-clock care, ordered by a physician and performed by skilled medical personnel, is designed to treat a medical condition.
- Intermediate care: This involves occasional nursing and rehabilitative care provided by registered nurses and certain other medical personnel under the supervision of a physician.
- Custodial care: This type of care is designed to help you perform the activities of daily living (e.g., bathing, eating, dressing). It can be provided by someone without professional medical skills but is supervised by a physician.

Medicaid can help you pay for nursing home care

Medicare (Part A), Medigap insurance, and Medicaid can each provide some assistance in paying for long-term care. However, Medicare and Medigap provide only short-term coverage for skilled care at nursing homes--only a certain number of days per year are covered. Also, they do not provide coverage for intermediate and custodial care in nursing homes.

In contrast, Medicaid (in most states) will pay for skilled care and intermediate care in nursing homes, and for custodial care at home. The bottom line is that most nursing home residents are left with only three alternatives for paying their nursing home bills: Medicaid, their own assets (e.g., cash, investments), and long-term care insurance (LTCI).

Although an LTCI policy may be an ideal solution, you may not be able to purchase such a policy later in life if you're uninsurable for health reasons, or if you find the premiums too high. If you don't want to spend your life savings on nursing home bills and can't afford LTCI premiums, qualifying for Medicaid may be your best bet. With proper planning, you may be able to qualify for Medicaid, protect your healthy spouse (if you have one), and even leave some assets to your loved ones after you're gone.

You must satisfy several requirements to qualify for Medicaid

Medicaid is a joint federal-state program that provides medical assistance to various low-income people, including those who are aged (i.e., 65 or older), disabled, or blind. It can pay for a number of costs, including hospital bills, physician services, and long-term care. Medicaid is the single largest payer of nursing home bills in America and is the last resort for people who have no other way to finance their long-term care. Although the eligibility rules vary from state to state, federal minimum standards and guidelines must be observed.

In addition to you meeting your state's medical and functional criteria for nursing home care, your assets and monthly income must each fall below certain limits if you are to qualify for Medicaid. However, several assets (which may include your family home) and a certain amount of income may be exempt or not counted.

Although many people are ineligible for Medicaid when they first enter a nursing home, several states allow elders to enter and then spend down their income and assets on nursing home bills to become eligible. This can be a great advantage. On the downside, though, you may have to kiss your life savings good-bye.

That's where Medicaid planning comes in. In determining your eligibility for Medicaid, a state may count only the income and assets that are legally available to you for paying bills. You can make assets unavailable by giving them away or by holding them in certain trusts. However, in some cases, such transfers may create a period of ineligibility before you can collect Medicaid. So, to engage in proper Medicaid planning, you should consult an experienced elder law attorney.

Choosing the right nursing home takes research

Because nursing homes have long waiting lists, you should research the nursing homes in your area before an emergency arises. If you plan on using Medicaid to pay for your nursing home care, make sure that the facility you select accepts Medicaid--not all nursing homes do. Many others restrict the number of Medicaid "beds" in the nursing home (some states, however, prohibit this). Also, be aware that if Medicaid will be paying for your nursing home care, you will not be entitled to a private room.

You should consider several factors when choosing a nursing home. These include:

- Level of medical care: Some homes provide mainly custodial care. If you think that you may need skilled nursing care in the future, don't choose a home that offers only custodial care.
- Cost of care: You will pay less at some facilities than at others. Compare the cost of each facility with the quality of care and the services provided.
- Recreational opportunities: Consider whether the nursing home organizes outside or in-house recreational activities for its residents.
- Appearance of grounds and facilities: The nursing home should be clean and well maintained. A bad smell is one sign of a poor-quality nursing home.
- Resident/staff ratio and interaction: Determine if the resident/staff ratio meets or exceeds state and federal requirements. Also, notice how staff members treat residents.

When you find a nursing home that you like, you should find out if a bed will be available for you, or if you can add your name to a waiting list. And remember, Medicaid planning should be done well before the need for a nursing home arises.

For more information on how to evaluate a nursing home, contact your state department of elder services.

Ownership of Life Insurance: Estate Planning

What are the ownership issues of life insurance?

In estate planning, life insurance is purchased for several reasons: (1) to provide cash to the insured's family for daily living expenses, (2) to provide cash for potential death taxes and estate expenses, and (3) to provide a shelter from income taxes (for beneficiaries), potential estate taxes, or gift taxes (for insureds). In order to ensure that your beneficiaries receive the maximum benefit from life insurance policies on your life, you must structure ownership of these policies to minimize income and potential estate taxes.

Tip: *To avoid taxes, you must also properly designate the beneficiaries.*

Who should own your life insurance?

Not you (the insured), if your estate is more than the applicable exclusion amount

Life insurance proceeds from policies on your life may be includable in your estate for estate tax purposes if you own the policy outright, have any "incidents of ownership" in the policy at the time of your death, or transfer ownership of the policy within three years of your death. Inclusion of life insurance proceeds in your estate is not a problem if your estate (including any includable life insurance proceeds) is less than or equal to the applicable exclusion amount ($11,200,000 in 2018, $5,490,000 in 2017). If your taxable estate (excluding any includable life insurance proceeds) exceeds the applicable exclusion amount, you (the insured) should consider alternate ownership of policies on your life.

Technical Note: *"Incidents of ownership" is a legal term that refers to the right of the insured to control the economic benefits of the policy. This definition encompasses more than outright ownership of the policy and includes the power: (1) to change the beneficiaries of the policy, (2) to pledge the policy for a loan, (3) to surrender or cancel the policy, (4) to assign the policy, or (5) to borrow against the surrender value of the policy. A reversionary interest in a life insurance policy is also treated as an incident of ownership in that policy and will result in inclusion of the value of the policy in the insured's estate if the value of the reversionary interest immediately before the insured's death exceeds 5 percent of the value of the policy. A reversionary interest in a life insurance policy includes the possibility that the policy or its proceeds may return to the decedent or his or her estate or may be subject to a power of disposition (e.g., a power of appointment) by the decedent.*

Not your spouse if you live in a community property state, if your estate is more than the applicable exclusion amount

Community property states treat all types of community property, including life insurance, as being owned one-half by each spouse. Thus, one-half of a life insurance policy on your life that is owned by your spouse may be includable in your estate for estate tax purposes. As discussed above, this is not a problem if your estate (including any includable life insurance proceeds) is less than or equal to the applicable exclusion amount. However, if your estate (excluding any otherwise includable life insurance policies) exceeds the applicable exclusion amount, you should consider having ownership of the policy reside with someone other than your spouse.

Another individual

One person can own a policy insuring the life of another. Proceeds of such a policy will not be includable in the insured's estate, but the value of the policy may be includable in the owner's estate if the owner dies before the insured.

Premiums may be paid by the owner, but not from joint assets or community property belonging to the insured.

An irrevocable trust

An irrevocable life insurance trust (ILIT) is a type of trust that may be used to keep life insurance proceeds out of the insured's estate for estate tax purposes. The trustee of the ILIT is the owner of the policy, and the ILIT is the beneficiary. Upon the insured's death, the proceeds are distributed to the ILIT and distribution to the beneficiaries of the ILIT is made according to the terms of the trust agreement.

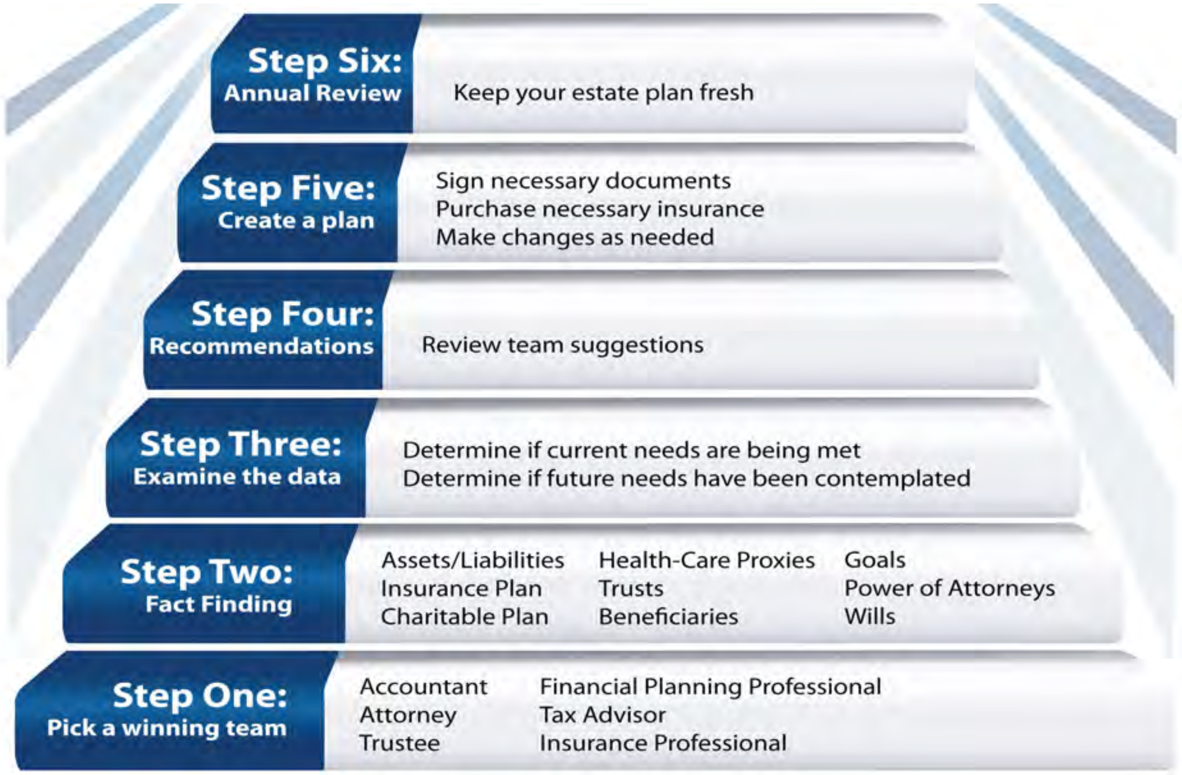
Caution: *An ILIT is a complex estate planning tool and must be properly created to be effective. If you are interested in taking advantage of such a device, you should seek the assistance of an estate planning professional in your state.*

What if you transfer an existing policy to another owner?

The proceeds may be taxable if you die within three years after the transfer

If you own a policy on your life, you may want to transfer ownership to another individual (e.g., to the beneficiary) to avoid inclusion of the proceeds in your estate. Transferring ownership of a policy is easy: Simply complete a change of ownership form provided by your insurance company. Remember, though, that even if you transfer ownership of an existing policy to another individual, it can be included in your estate if you die within three years of the transfer.

Steps to Estate Planning Success



Trust Basics

Whether you're seeking to manage your own assets, control how your assets are distributed after your death, or plan for incapacity, trusts can help you accomplish your estate planning goals. Their power is in their versatility — many types of trusts exist, each designed for a specific purpose. Although trust law is complex and establishing a trust requires the services of an experienced attorney, mastering the basics isn't hard.

What is a trust?

A trust is a legal entity that holds assets for the benefit of another. Basically, it's like a container that holds money or property for somebody else. You can put practically any kind of asset into a trust, including cash, stocks, bonds, insurance policies, real estate, and artwork. The assets you choose to put in a trust depend largely on your goals. For example, if you want the trust to generate income, you may want to put income-producing securities, such as bonds, in your trust. Or, if you want your trust to create a pool of cash that may be accessible to pay any estate taxes due at your death or to provide for your family, you might want to fund your trust with a life insurance policy.

When you create and fund a trust, you are known as the grantor (or sometimes, the settlor or trustor). The grantor names people, known as beneficiaries, who will benefit from the trust. Beneficiaries are usually your family and loved ones but can be anyone, even a charity. Beneficiaries may receive income from the trust or may have access to the principal of the trust either during your lifetime or after you die. The trustee is responsible for administering the trust, managing the assets, and distributing income and/or principal according to the terms of the trust. Depending on the purpose of the trust, you can name yourself, another person, or an institution, such as a bank, to be the trustee. You can even name more than one trustee if you like.

Why create a trust?

Since trusts can be used for many purposes, they are popular estate planning tools. Trusts are often used to:

- Minimize estate taxes
- Shield assets from potential creditors
- Avoid the expense and delay of probating your will
- Preserve assets for your children until they are grown (in case you should die while they are still minors)
- Create a pool of investments that can be managed by professional money managers
- Set up a fund for your own support in the event of incapacity

- Shift part of your income tax burden to beneficiaries in lower tax brackets
- Provide benefits for charity

The type of trust used, and the mechanics of its creation, will differ depending on what you are trying to accomplish. In fact, you may need more than one type of trust to accomplish all of your goals. And since some of the following disadvantages may affect you, discuss the pros and cons of setting up any trust with your attorney and financial professional before you proceed:

- A trust can be expensive to set up and maintain — trustee fees, professional fees, and filing fees must be paid
- Depending on the type of trust you choose, you may give up some control over the assets in the trust
- Maintaining the trust and complying with recording and notice requirements can take up considerable time
- Income generated by trust assets and not distributed to trust beneficiaries may be taxed at a higher income tax rate than your individual rate

The duties of the trustee

The trustee of the trust is a fiduciary, someone who owes a special duty of loyalty to the beneficiaries. The trustee must act in the best interests of the beneficiaries at all times. For example, the trustee must preserve, protect, and invest the trust assets for the benefit of the beneficiaries. The trustee must also keep complete and accurate records, exercise reasonable care and skill when managing the trust, prudently invest the trust assets, and avoid mixing trust assets with any other assets, especially his or her own. A trustee lacking specialized knowledge can hire professionals such as attorneys, accountants, brokers, and bankers if it is wise to do so. However, the trustee can't merely delegate responsibilities to someone else.

Although many of the trustee's duties are established by state law, others are defined by the trust document. If you are the trust grantor, you can help determine some of these duties when you set up the trust.

Living (revocable) trust

A living trust is a special type of trust. It's a legal entity that you create while you're alive to own property such as your house, a boat, or investments. Property that passes through a living trust is not subject to probate — it doesn't get treated like the property in your will. This means that the transfer of property through a living trust is not held up while the probate process is pending (sometimes up to two years or more). Instead, the trustee will transfer the assets to the beneficiaries according to your instructions. The transfer can be immediate, or if you want to delay the transfer, you can direct that the trustee hold the assets until some specific time, such as the marriage of the beneficiary or the attainment of a certain age.

Living trusts are attractive because they are revocable. You maintain control — you can change the trust or even dissolve it for as long as you live. Living trusts are also private. Unlike a will, a living trust is not part of the public record. No one can review details of the trust documents unless you allow it.

Living trusts can also be used to help you protect and manage your assets if you become incapacitated. If you can no longer handle your own affairs, your trustee (or a successor trustee) steps in and manages your property. Your trustee has a duty to administer the trust according to its terms, and must always act with your best interests in mind. In the absence of a trust, a court could appoint a guardian to manage your property.

Despite these benefits, living trusts have some drawbacks. Assets in a living trust are not protected from creditors, and you are subject to income taxes on income earned by the trust. In addition, you cannot avoid estate taxes using a living trust.

Irrevocable trusts

Unlike a living trust, an irrevocable trust can't be changed or dissolved once it has been created. You generally can't remove assets, change beneficiaries, or rewrite any of the terms of the trust. Still, an irrevocable trust is a valuable estate planning tool. First, you transfer assets into the trust — assets you don't mind losing control over. You may have to pay gift taxes on the value of the property transferred at the time of transfer.

Provided that you have given up control of the property, all of the property in the trust, plus all future appreciation on the property, is out of your taxable estate. That means your ultimate estate tax liability may be less, resulting in more passing to your beneficiaries. Property transferred to your beneficiaries through an irrevocable trust will also avoid probate. As a bonus, property in an irrevocable trust may be protected from your creditors.

There are many different kinds of irrevocable trusts. Many have special provisions and are used for special purposes. Some irrevocable trusts hold life insurance policies or personal residences. You can even set up an irrevocable trust to generate income for you.

Testamentary trusts

Trusts can also be established by your will. These trusts don't come into existence until your will is probated. At that point, selected assets passing through your will can "pour over" into the trust. From that point on, these trusts work very much like other trusts. The terms of the trust document control how the assets within the trust are managed and distributed to your heirs. Since you have a say in how the trust terms are written, these types of trusts give you a certain amount of control over how the assets are used, even after your death.

Understanding Probate

When you die, you leave behind your estate. Your estate consists of your assets — all of your money, real estate, and worldly belongings. Your estate also includes your debts, expenses, and unpaid taxes. After you die, somebody must take charge of your estate and settle your affairs. This person will take your estate through probate, a court-supervised process that winds up your financial affairs after your death. The proceedings take place in the state where you were living at the time of your death. Owning property in more than one state can result in multiple probate proceedings. This is known as ancillary probate.

How does probate start?

If your estate is subject to probate, someone (usually a family member) begins the process by filing an application for the probate of your will. The application is known as a petition. The petitioner brings it to the probate court along with your will. Usually, the petitioner will file an application for the appointment of an executor at the same time. The court first rules on the validity of the will. Assuming that the will meets all of your state's legal requirements, the court will then rule on the application for an executor. If the executor meets your state's requirements and is otherwise fit to serve, the court generally approves the application.

What's an executor?

The executor is the person whom you choose to handle the settlement of your estate. Typically, the executor is a spouse or a close family member, but you may want to name a professional executor, such as a bank or attorney. You'll want to choose someone whom you trust will be able to carry out your wishes as stated in the will. The executor has a fiduciary duty — that is, a heightened responsibility to be honest, impartial, and financially responsible. Now, this doesn't mean that your executor has to be an attorney or tax wizard, but merely has the common sense to know when to ask for specialized advice.

Your executor's duties may include:

- Finding and collecting your assets, including outstanding debts owed to you
- Inventorying and appraising your assets
- Giving notice to your creditors (e.g., credit card companies, banks, retail stores)
- Filing an estate tax return and paying estate taxes, if any
- Paying any debts or other taxes
- Distributing your assets according to your will and the law
- Providing a detailed report of how the estate was settled to the court and all interested parties

The probate court supervises and oversees the entire process. Some states allow a less formal process if the estate is small and there are no complicated issues to resolve. In those states allowing informal probate, the court may be involved only indirectly. This may speed up the probate process, which can take years.

What if you don't name an executor?

If you don't name an executor in your will, or if the executor can't serve for some reason, the court will appoint an administrator to settle your estate according to the terms of your will. If you die without a will, the court will also appoint an administrator to settle your estate. This administrator will follow a special set of laws, known as intestacy laws, that are made for such situations.

Is all of your property subject to probate?

Although most assets in your estate may pass through the probate process, other assets may not. It often depends on the type of asset or how an asset is titled. For example, many married couples own their residence jointly with rights of survivorship. Property owned in this manner bypasses probate entirely and passes by "operation of law." That is, at death, the property passes directly to the joint owner regardless of the terms of the will and without going through probate. Other assets that may bypass probate include:

- Investments and bank accounts set up to pass automatically to a named person at death (payable on death)
- Life insurance policies with a named beneficiary (someone other than the estate)
- Retirement plans with a named beneficiary
- Other property owned jointly with rights of survivorship

Wills: The Cornerstone of Your Estate Plan

If you care about what happens to your money, home, and other property after you die, you need to do some estate planning. There are many tools you can use to achieve your estate planning goals, but a will is probably the most vital. Even if you're young or your estate is modest, you should always have a legally valid and up-to-date will. This is especially important if you have minor children because, in many states, your will is the only legal way you can name a guardian for them. Although a will doesn't have to be drafted by an attorney to be valid, seeking an attorney's help can ensure that your will accomplishes what you intend.

Wills avoid intestacy

Probably the greatest advantage of a will is that it allows you to avoid intestacy. That is, with a will you get to choose who will get your property, rather than leave it up to state law. State intestate succession laws, in effect, provide a will for you if you die without one. This "intestate's will" distributes your property, in general terms, to your closest blood relatives in proportions dictated by law. However, the state's distribution may not be what you would have wanted. Intestacy also has other disadvantages, which include the possibility that your estate will owe more taxes than it would if you had created a valid will.

Wills distribute property according to your wishes

Wills allow you to leave bequests (gifts) to anyone you want. You can leave your property to a surviving spouse, a child, other relatives, friends, a trust, a charity, or anyone you choose. There are some limits, however, on how you can distribute property using a will. For instance, your spouse may have certain rights with respect to your property, regardless of the provisions of your will.

Gifts through your will take the form of specific bequests (e.g., an heirloom, jewelry, furniture, or cash), general bequests (e.g., a percentage of your property), or a residuary bequest of what's left after your other gifts.

Wills allow you to nominate a guardian for your minor children

In many states, a will is your only means of stating who you want to act as legal guardian for your minor children if you die. You can name a personal guardian, who takes personal custody of the children, and a property guardian, who manages the children's assets. This can be the same person or different people. The probate court has final approval, but courts will usually approve your choice of guardian unless there are compelling reasons not to.

Wills allow you to nominate an executor

A will allows you to designate a person as your executor to act as your legal representative after your death. An executor carries out many estate settlement tasks, including locating your will, collecting your assets, paying legitimate creditor claims, paying any taxes owed by your estate, and distributing any remaining assets to your beneficiaries. Like naming a guardian, the probate court has final approval but will usually approve whomever you nominate.

Wills specify how to pay estate taxes and other expenses

The way in which estate taxes and other expenses are divided among your heirs is generally determined by state law unless you direct otherwise in your will. To ensure that the specific bequests you make to your beneficiaries are not reduced by taxes and other expenses, you can provide in your will that these costs be paid from your residuary estate. Or, you can specify which assets should be used or sold to pay these costs.

Wills can create a testamentary trust

You can create a trust in your will, known as a testamentary trust, that comes into being when your will is probated. Your will sets out the terms of the trust, such as who the trustee is, who the beneficiaries are, how the trust is funded, how the distributions should be made, and when the trust terminates. This can be especially important if you have a spouse or minor children who are unable to manage assets or property themselves.

Wills can fund a living trust

A living trust is a trust that you create during your lifetime. If you have a living trust, your will can transfer any assets that were not transferred to the trust while you were alive. This is known as a pourover will because the will "pours over" your estate to your living trust.

Wills can help minimize taxes

Your will gives you the chance to minimize taxes and other costs. For instance, if you draft a will that leaves your entire estate to your U.S. citizen spouse, none of your property will be taxable when you die (if your spouse survives you) because it is fully deductible under the unlimited marital deduction. However, if your estate is distributed according to intestacy rules, a portion of the property may be subject to estate taxes if it is distributed to heirs other than your U.S. citizen spouse.

Assets disposed of through a will are subject to probate

Probate is the court-supervised process of administering and proving a will. Probate can be expensive and time consuming, and probate records are available to the public. Several factors can affect the length of probate, including the size and complexity of the estate, challenges to the will or its provisions, creditor claims against the estate, state probate laws, the state court system, and tax issues. Owning property in more than one state can result in multiple probate proceedings. This is known as ancillary probate. Generally, real estate is probated in the state in which it is located, and personal property is probated in the state in which you are domiciled (i.e., reside) at the time of your death.

Will provisions can be challenged in court

Although it doesn't happen often, the validity of your will can be challenged, usually by an unhappy beneficiary or a disinherited heir. Some common claims include:

- You lacked testamentary capacity when you signed the will
- You were unduly influenced by another individual when you drew up the will
- The will was forged or was otherwise improperly executed
- The will was revoked

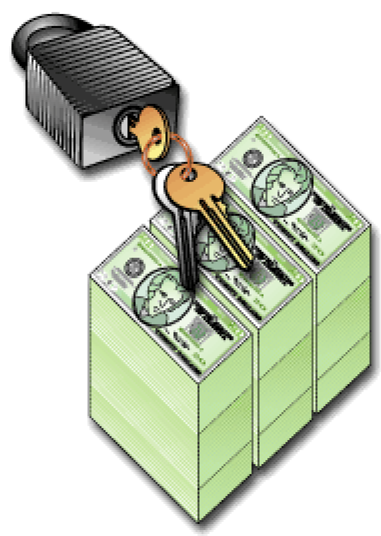
Advantages of Trusts

Why you might consider discussing trusts with your attorney

- Trusts may be used to minimize estate taxes for married individuals with substantial assets.
- Trusts provide management assistance for your heirs.*
- Contingent trusts for minors (which take effect in the event that both parents die) may be used to avoid the costs of having a court-appointed guardian to manage your children's assets.
- Properly funded trusts avoid many of the administrative costs of probate (e.g., attorney fees, document filing fees).
- Generally, revocable living trusts will keep the distribution of your estate private.
- Trusts can be used to dispense income to intermediate beneficiaries (e.g., children, elderly parents) before final property distribution.
- Trusts can ensure that assets go to your intended beneficiaries. For example, if you have children from a prior marriage you can make sure that they, as well as a current spouse, are provided for.
- Trusts can minimize income taxes by allowing the shifting of income among beneficiaries.
- Properly structured irrevocable life insurance trusts can provide liquidity for estate settlement needs while removing the policy proceeds from estate taxation at the death of the insured.

What is a trust?

A trust is a legal entity that is created for the purpose of transferring property to a trustee for the benefit of a third person (beneficiary). The trustee manages the property for the beneficiary according to the terms specified in the trust document.



*This is particularly important for minors and incapacitated adults who may need support, maintenance, and/or education over a long period of time, or for adults who have difficulty managing money.

Gift and Estate Taxes

If you give away money or property during your life, those transfers may be subject to federal gift and estate tax and perhaps state gift tax. The money and property you own when you die (i.e., your estate) may also be subject to federal gift and estate tax and some form of state death tax. These property transfers may also be subject to generation-skipping transfer taxes. You should understand all of these taxes, especially since the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (the 2001 Tax Act), the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Act), the American Taxpayer Relief Act of 2012 (the 2012 Tax Act), and the Tax Cuts and Jobs Act. The recent Tax Acts contain several changes that make estate planning much easier.

Federal gift and estate tax — background

Under pre-2001 Tax Act law, no federal gift and estate tax was imposed on the first $675,000 of combined transfers (those made during life and those made at death). The tax rate tables were unified into one — that is, the same rates applied to gifts made and property owned by persons who died in 2001. Like income tax rates, gift and estate tax rates were graduated. Under this unified system, the recipient of a lifetime gift received a carryover basis in the property received, while the recipient of a bequest, or gift made at death, got a step-up in basis (usually fair market value on the date of death of the person who made the bequest or gift).

The 2001 Tax Act, the 2010 Tax Act, the 2012 Tax Act, and the Tax Cuts and Jobs Act substantially changed this tax regime.

Federal gift and estate tax — current

The 2001 Tax Act increased the applicable exclusion amount for gift tax purposes to $1 million through 2010. The applicable exclusion amount for estate tax purposes gradually increased over the years until it reached $3.5 million in 2009. The 2010 Tax Act repealed the estate tax for 2010 (and taxpayers received a carryover income tax basis in the property transferred at death), or taxpayers could elect to pay the estate tax (and get the step-up in basis). The 2010 Tax Act also re-unified the gift and estate tax and increased the applicable exclusion amount to $5,120,000 in 2012. The top gift and estate tax rate was 35 percent in 2012. The 2012 Tax Act increased the applicable exclusion amount to $5,490,000 (in 2017) and the top gift and estate tax rate to 40 percent (in 2013 and later years). The Tax Cuts and Jobs Act, signed into law in December 2017, doubled the gift and estate tax exclusion amount and the GST tax exemption (see below) to $11,180,000 in 2018. After 2025, they are scheduled to revert to their pre-2018 levels and cut by about one-half.

However, many transfers can still be made tax free, including:

- Gifts to your U.S. citizen spouse; you may give up to $152,000 in 2018 ($149,000 in 2017) tax free to your noncitizen spouse

- Gifts to qualified charities
- Gifts totaling up to $15,000 (in 2018, $14,000 in 2017) to any one person or entity during the tax year, or $30,000 (in 2018, $28,000 in 2017) if the gift is made by both you and your spouse (and you are both U.S. citizens)
- Amounts paid on behalf of any individual as tuition to an educational organization or to any person who provides medical care for an individual

Federal generation-skipping transfer tax

The federal generation-skipping transfer (GST) tax imposes tax on transfers of property you make, either during life or at death, to someone who is two or more generations below you, such as a grandchild. The GST tax is imposed in addition to, not instead of, federal gift and estate tax. You need to be aware of the GST tax if you make cumulative generation-skipping transfers in excess of the GST tax exemption ($11,180,000 in 2018, $5,490,000 in 2017). A flat tax equal to the highest estate tax bracket in effect in the year you make the transfer (40 percent in 2017 and 2018) is imposed on every transfer you make after your exemption has been exhausted.

State transfer taxes

Currently, a few states impose a gift tax, and a few states impose a generation-skipping transfer tax. Some states also impose a death tax, which could be in the form of estate tax, inheritance tax, or credit estate tax (also known as a sponge or pickup tax). Contact an attorney or your state's department of revenue or taxation to find out more information

Federal Estate Tax Rates At-a-Glance

2017 and 2018 Gift Tax and Estate Tax Rate Schedule

Taxable Gift/Estate		Tentative Tax Equals		
exceeds	**but does not exceed**	**base tax of**	**plus**	**of amount over**
$0	$10,000	$0	18%	$0
$10,000	$20,000	$1,800	20%	$10,000
$20,000	$40,000	$3,800	22%	$20,000
$40,000	$60,000	$8,200	24%	$40,000
$60,000	$80,000	$13,000	26%	$60,000
$80,000	$100,000	$18,200	28%	$80,000
$100,000	$150,000	$23,800	30%	$100,000
$150,000	$250,000	$38,800	32%	$150,000
$250,000	$500,000	$70,800	34%	$250,000
$500,000	$750,000	$155,800	37%	$500,000
$750,000	$1,000,000	$248,300	39%	$750,000
$1,000,000 +		$345,800	40%	$1,000,000
Credit shelter amount $11,200,000 in 2018; $5,490,000 in 2017		**Unified credit amount $2,185,800 in 2018; $2,141,800 in 2017**		

The Tax Cuts and Jobs Act, signed into law in December 2017, doubled the gift and estate tax basic exclusion amount to about $11,200,000 in 2018. After 2025, the exclusion is scheduled to revert to its pre-2018 level and be cut by about one-half.

Estimating Estate Tax Liability

Introduction

As the old saying goes, you can't cheat death or taxes. In fact, you might still owe taxes after you die! One of these taxes is the federal estate tax. Generally, this is a tax that may be imposed on property owned by you (or deemed to be owned by you) at the time of your death.

Any U.S. citizen who leaves an estate (plus adjusted taxable gifts) in excess of the gift and estate tax applicable exclusion amount ($11,200,000 in 2018, $5,490,000 in 2017) may be subject to estate tax.

Estimating and planning for estate tax may be important to you because this could be one of the largest expenses your estate may have to pay. It also means that a significant part of your estate may go to the government and not to your beneficiaries.

Estate tax may be imposed on all U.S. citizens and/or residents. If you are a nonresident alien who owns property in the United States, your estate may be subject to estate tax; however, certain adjustments and requirements will apply. Although estimating estate tax can be complex, don't be overwhelmed. If you proceed step by step, you can do it. Estimating estate tax is an important step in formulating and implementing a successful master estate plan. The peace of mind that comes with implementing a successful master estate plan should be worth your time and trouble.

Caution: *Transfers of property you make to a person who is more than one generation below you (e.g., a grandchild or great-nephew) may also be subject to the federal generation-skipping transfer (GST) tax.*

Caution: *Some states also impose their own death taxes and GST tax. State death tax rates vary from state to state but are generally lower than the federal estate tax rates. However, states often will impose death taxes on estates of lesser value than the federal government. To avoid double taxation, a deduction is allowed for certain state death taxes you pay.*

How does the unified tax system work?

Before 1976 (when Congress unified estate and gift taxes), gifts made during life (taxable gifts) were reported — and any gift tax owed was paid — on an annual basis. After death, estate tax was imposed only on property owned at death (gross estate).

Since 1976, generally, taxable gifts are still reported — and any gift tax owed is paid — annually (generally, you must file a gift tax return and pay gift tax due, if any, by April 15 of the year following the year in which you make a taxable gift). But upon death, all post-1976 taxable gifts are added to your taxable estate for estate tax calculation purposes, even though a gift tax return may already be filed and a gift tax paid (post-1976 gift tax paid is subtracted from the estate tax owed). Congress unified the gift tax and estate tax systems so that: (1) you can't avoid estate tax by giving your wealth away before you die, and (2) you pay tax on the cumulative amount of wealth you give away (this pushes your estate into a higher tax bracket).

How does the estate tax work?

Estate tax may be imposed on your taxable estate. The taxable estate is your gross estate (the value of your property when you die) reduced by the qualified conservation easement exclusion and various deductions.

Your cumulative taxable transfers are calculated by adding adjustable taxable gifts you made during life to your taxable estate. A tentative tax is calculated on your cumulative taxable transfers, as well as on your adjusted taxable gifts. The tax is calculated under the Unified Tax Rate Schedule, which is graduated; the larger the value of your cumulative transfers, the greater the tax rate (much like your income tax). A tentative estate tax is calculated by subtracting the gift tax on adjustable taxable gifts from the estate tax on cumulative taxable transfers.

Credits are subtracted from the tentative estate tax, resulting in the estate tax that is owed.

The estate tax calculation looks something like this:

	Gross Estate
-	Deductions

=	Taxable Estate
+	Adjusted Taxable Gifts
=	Cumulative Taxable Transfers
	Tax on Cumulative Taxable Transfers
-	Tax on Adjusted Taxable Gifts
=	Tentative Estate Tax
-	Credits
=	Estate Tax Owed

The maximum estate tax rate in effect is 40 percent (in 2017 and 2018).

Tip: *If you have not made taxable gifts during your lifetime, there is a shortcut that can be used to estimate what your estate tax would be if you were to die in 2018. Simply subtract the applicable exclusion amount from the taxable estate, and multiply this amount by 40 percent. For example, estate tax on a $12,200,000 taxable estate for a decedent dying in 2018 would be $400,000 [$12,200,000 taxable estate minus $11,200,000 applicable exclusion amount equals $1,000,000; multiplied by the 40 percent top tax rate equals $400,000].*

Caution: *In general, estate tax should not be estimated by subtracting the applicable exclusion amount from the taxable estate, and then calculating tax on this amount from the gift and estate tax table with brackets. This will generally underestimate the amount of tax.*

How is estate tax calculated?

Calculating estate tax is similar to calculating income tax. It is basically a four-step process.

Determine what is taxable

The first step in estimating estate tax is to determine what is subject to tax. This includes property owned by you (or deemed to be owned by you) at the time of your death (the gross estate).

Gross estate

Identify taxable property. List all your property and property interests — of any description, wherever located — at the time of your death. A word of caution: What you do not ordinarily think of as being your property may be considered your property by the IRS for estate tax purposes. This includes property that passes through probate and property inherited directly by joint owners or beneficiaries. Generally, your property includes:

- Real estate
- Personal property (e.g., cash, insurance proceeds, cars, furniture, jewelry, art objects)
- Intangible property (e.g., copyrights, patents, stocks, bonds, notes)

Put a value on what you have identified. Assign a value to each property item you have identified. Generally, this is the fair market value (FMV) on the valuation date, though other valuation methods may apply. Simply stated, FMV means the price at which property would sell for on the open market. The valuation date is either the date of death or, if elected by your personal representative, six months after the date of your death.

Example(s): *At the time of his death, Adam owned his own home with a FMV of $200,000, furnishings and appliances with a FMV of $25,000, and a car with a FMV of $5,000. He also had $20,000 in his bank account. Adam's gross estate is $250,000 ($200,000 plus $25,000 plus $5,000 plus $20,000).*

Determine what isn't taxed

The second step in the estate tax calculation is to determine what isn't taxed. Certain amounts are excluded from the gross estate and deductions are allowed to be subtracted from your gross estate. The result is your taxable estate.

Exclusions:

The following exclusions are allowed:

- Qualified conservation easement exclusion: A limited amount of the value of land subject to a qualified conservation easement can be excluded from your gross estate.
- Social Security benefits: Any benefits payable to your heirs under the Social Security system are excluded from your gross estate (unlike some life insurance or retirement plan benefits).
- Workers' compensation death benefits: Any benefits payable to your heirs under your state's workers' compensation law are excluded from your gross estate.

Technical Note: *While the applicable exclusion amount (or basic exclusion amount; sometimes referred to as an exemption) indicates the amount of property that can be sheltered from federal gift or estate tax by the unified credit, the applicable exclusion amount is not actually an exclusion (or exemption). So do not reduce the gross estate by the applicable exclusion amount. Instead, the unified credit is subtracted below as a credit against tax.*

Deductions:

The following deductions are allowed:

- Expenses: Certain expenses incurred by your estate can be deducted from your gross estate. These expenses include:
  - Funeral expense
  - Administration expense (e.g., executor's or administrator's fees, court costs, attorney's fees, appraiser's fees)
  - Certain debts of the decedent
  - Certain taxes
  - Certain claims against your estate
  - Casualty losses suffered during the administration of your estate
- Unlimited marital deduction: The unlimited marital deduction is one of the most significant deductions allowed. It lets you deduct the value of property you leave to your spouse from your gross estate. Although this deduction is unlimited, only certain property interests qualify, and certain conditions and requirements must be satisfied.

Tip: *If your spouse is not a U.S. citizen, the marital deduction is generally not available unless you use a qualified domestic trust (QDOT).*

- Charitable deduction: The entire value of property you leave to charity is deductible from your gross estate. The gift must be to a qualifying organization and must be for a public purpose. Gifts to individuals, no matter how needy, do not qualify. Certain conditions must be met to qualify for this deduction, but the amount is not limited as it is with the income tax deduction.
- State death tax deduction: State inheritance or estate taxes (collectively referred to as state death taxes) paid are deductible from the gross estate. Generally, the deduction can be claimed only if such taxes are paid within four years after the federal estate tax return has been filed.

Taxable estate

As noted above, certain amounts are excluded from, and deductions are subtracted from, your gross estate. The result is your taxable estate.

This is what your calculation should look like at this point:

	Gross Estate
-	Deductions
=	Taxable Estate

Calculate tentative estate tax

The third step is calculate the tentative estate tax. For this purpose, the taxable estate is added to your adjusted taxable gifts, resulting in your cumulative taxable transfers.

Generally, adjusted taxable gifts are gifts made after 1976 that are not "qualified transfers" for educational or medical purposes or transfers that qualify for the annual gift tax exclusion, marital deduction, or charitable deduction. Generally, the value of a gift is the FMV of the property on the date the gift is made.

A tentative tax is calculated on your cumulative taxable transfers, as well as on your adjusted taxable gifts. The tax is calculated under the Unified Tax Rate Schedule for gift tax and estate tax, which is graduated. A tentative estate tax is calculated by subtracting the gift tax on adjustable taxable gifts from the estate tax on cumulative taxable transfers. [The gift tax on adjustable taxable gifts is calculated as reduced by the unified credit available in the year of any gift.]

This is what your calculation should look like at this point:

	Gross Estate
-	Deductions
=	Taxable Estate
+	Adjusted Taxable Gifts
=	Cumulative Taxable Transfers
	Tax on Cumulative Taxable Transfers
-	Tax on Adjusted Taxable Gifts
=	Tentative Estate Tax

Deduct credits from your tentative estate tax

Once your tentative estate tax has been calculated, there are credits available to apply against the tax.

- Unified credit (applicable exclusion amount): The unified credit ($2,185,800 in 2018, $2,141,800 in 2017) allows you to pass an amount referred to as the basic exclusion amount (part of the applicable exclusion amount) free from gift and estate tax. This lifetime exclusion (which is sometimes referred to as an exemption) effectively exempts $11,200,000 (in 2018, $5,490,000 in 2017) from gift tax and estate tax. For 2011 and later years, the exclusion amount is portable, that is, any exemption that is unused by the first spouse to die may be used by the surviving spouse for gift tax and estate tax. [Technically, the Internal Revenue Code refers to the portable unused exemption as the deceased spousal unused exclusion amount (DSUEA).]
- Credit for gift taxes paid: You are allowed to deduct the gift tax paid on taxable gifts you included in your gross estate if the gift was made before 1977.
- Foreign death tax credit: Like the state death tax credit, the foreign death tax credit prevents double taxation. This credit is allowed for death taxes paid to a foreign country or U.S. possession on property included in your gross estate and situated in that country or possession.
- Credit for federal estate tax on prior transfers: If your gross estate includes property that was transferred to you by will, gift, or inheritance, and on which estate tax has already been paid, you may be entitled to a credit.

This is what your calculation should finally look like:

	Gross Estate
-	Deductions
=	Taxable Estate
+	Adjusted Taxable Gifts
=	Cumulative Taxable Transfers
	Tax on Cumulative Taxable Transfers
-	Tax on Adjusted Taxable Gifts

=	Tentative Estate Tax
-	Credits
=	Estate Tax Owed

What else should you know about estate tax?

Your personal representative is responsible for filing your estate tax return and paying estate tax owed, if any. Your estate tax return and payment of estate tax is due within 9 months after your death. An estate will be allowed an automatic 6-month extension of time beyond the prescribed 9 months if Form 4768 is filed on or before the due date for filing Form 706. If an estate does not file for an automatic 6-month extension, an extension of up to 12 months can be obtained by showing reasonable cause. The IRS doesn't define reasonable cause, but uses its own discretion to determine whether to grant or deny a request for an extension. The IRS may grant a series of extensions running as long as 10 years.

If you're a business owner, under Section 6166, your personal representative may be able to defer the estate tax owed on your business interest.

If your estate owes tax, it must be paid before your beneficiaries can receive what you have left them. The IRS will have a lien against your estate and has the ability to seize or levy the estate property if the tax is not paid when due.

Tip: *Making special provisions in your will for paying estate tax will ensure that your beneficiaries get what you intend for them to receive.*

What is funeral insurance, and do I need it?

Question:

What is funeral insurance, and do I need it?

Answer:

Funeral insurance is a way to spare your loved ones the financial burden of having to pay for your final expenses. However, not all funeral insurance policies are alike. Different types of funeral insurance are available, and policies can vary widely. In general, they work by you purchasing a policy that will cover your final expenses, usually a few thousand dollars. You pay the premiums (either in a lump sum or spread out over a certain number of years), and when you die, the death benefit is used to pay for your funeral.

Funeral insurance policies are often sold through a funeral director acting as an agent on behalf of an insurance company. However, some of the larger national funeral home chains are beginning to sell funeral insurance.

If you're concerned that funds won't be available to pay for your funeral costs, or that these costs would be a large burden to your family, a funeral insurance policy might be appropriate for you. However, before you decide, explore the possibility of purchasing a small term life insurance policy as an alternative. If you have sufficient assets to pay for your own funeral, you probably don't need funeral insurance.

Currently, there is no federal law regulating funeral insurance, and state regulations vary. And many individuals--especially the elderly--have been victimized by funeral insurance scams. As a result, it may be wise to consult a professional advisor to find out if funeral insurance fits into your overall estate plan.

How can I keep my business in the family?

Answer:

There are several ways to keep your business in the family. The method you choose will depend on whether you wish to keep ownership and control of the business until your death, or begin transferring ownership (and possibly control) to your family during your lifetime. In addition, your options will be affected by the business entity itself. A sole proprietorship, for example, may have different options than a partnership or a corporation. The presence of a buy-sell agreement or another restrictive agreement between current owners may also impact your options. Each of the options for keeping your business in the family bears its own tax consequences and can be affected by your overall estate planning goals.

If you wish to maintain ownership until your death, you can transfer your business to family members using your will. Depending on the value of your estate and the year in which you die, your business interest may be included in your estate and subject to estate taxes under this method. However, under certain circumstances, valuation discounts may be available to lower the taxable value of your business interest. See a tax attorney for more information.

If you want to begin transferring ownership of the business during your lifetime, you can structure the transfers to occur in such a manner that you retain the controlling interest until you are ready to fully remove yourself from the business. You can make lifetime gifts of interests in your business to your family members. Depending on the amount of the gift and to whom the gift is made, lifetime transfers of your business interest may be subject to federal and/or state gift tax. (See a tax attorney for more information.) Or, you can combine lifetime gifting with an outright sale of your interest. The sale can occur either during your lifetime or after your death. You may want to use a trust to facilitate the transfer of your business, or transfer ownership through the use of another entity, such as a family limited partnership.

A buy-sell agreement can be established now to provide for the future sale of your business to one or more family members. Buy-sell agreements are legal agreements that establish a buyer for your business, the price or pricing mechanism to be used, and the events (such as retirement, death, or disability) that will trigger the sale. Be aware that once you are bound under such an agreement, you may not be allowed to make gifts of your business interest or sell to anyone other than the buyer named in the agreement, depending on the terms of the agreement.

What will happen if I die without a will?

Answer:

Some people leave instructions about who gets what property in a legal document known as a will. If you do not have a will, you leave no legal instructions about how your property is to be distributed to your heirs.

The state then steps in and dictates how your property will be distributed. The state does this by following laws known as intestacy laws. Each of the states has adopted its own intestacy laws, so the pattern of distribution varies from state to state. However, a typical pattern may be that half of the property goes to the spouse, and the other half is split equally among the children.

The major disadvantage of this is that your property may not be distributed according to your wishes.

There are other drawbacks to this situation, as well. Instructions about other special matters, such as who will settle the estate or who will take care of minor children, are also left in a will. If you do not have a will, these matters will also be determined by the state. Although the state will do what it thinks is in the best interest of your family, its actions may not be consistent with what you would have wanted.

What is the difference between a power of attorney and a durable power of attorney?

Answer:

A power of attorney is a legal document that authorizes someone to act for you. You name someone known as an agent or attorney-in-fact (though the person need not be an attorney) who steps into your shoes, legally speaking. You can authorize your agent to do such things as sign checks and tax returns, enter into contracts, buy or sell real estate, deposit or withdraw funds, run a business, or anything else you do for yourself.

A power of attorney can be broad or limited. Since the power-of-attorney document is tailored for its specific purpose, your agent cannot act outside the scope designated in the document. For example, you may own a home in another state that you want to sell. Instead of traveling to that state to complete all the necessary paperwork, you can authorize someone already in that state to do this for you. When the transactions to sell the home are complete, the agency relationship ends, and the agent no longer holds any power.

A regular power of attorney ends when its purpose is fulfilled or at your incapacity or death.

A durable power of attorney serves the same function as a power of attorney. However, as its name implies, the agency relationship remains effective even if you become incapacitated. This makes the durable power of attorney an important estate planning tool. If incapacity should strike you, your agent can maintain your financial affairs until you are again able to do so, without any need for court involvement. That way, your family's needs continue to be provided for, and the risk of financial loss is reduced. A durable power of attorney ends at your death.

I just made a gift. Do I have to file a gift tax return?

A federal gift tax return must be filed if any gifts you made during the calendar year were other than:

- Gifts to your U.S. citizen spouse
- Gifts to a political organization for its own use
- Gifts to qualified charities, if no other interest has been transferred for less than adequate consideration or for other than a charitable use
- Gifts totaling $15,000 (in 2018, $14,000 in 2017) or less to any one individual, unless you and your spouse are "gift-splitting"
- Amounts paid on behalf of any individual as tuition to an educational organization or to any person who provides medical care for an individual

However, you may want to file a gift tax return in certain circumstances even if the rules do not require it. For example, you should consider filing whenever you sell hard-to-value assets, such as real estate or stock in a family business, to a relative. This is because the IRS can claim that transactions between family members were actually gifts in disguise. Disclosing such transactions on a gift tax return means that the IRS has only three years to challenge the value.

If you file a federal gift tax return, you must use Form 709 and file by April 15 of the year following the year in which the gift was made.

The federal gift tax rules are complex. If you believe you have made gifts that might be subject to gift tax, you should consult an experienced tax specialist. Check with your state about its own rules regarding gifts, too.

IMPORTANT DISCLOSURES

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