

# THE MECHANICS OF ESTATE AND GENERATION TRANSITION PLANNING

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## 10) WHAT IS ESTATE PLANNING?

- Much broader in scope than typically defined (i.e., more than a will).
- The entire process of arranging your assets (and other affairs), both during your life and after your death, in a way that maximizes the accomplishment of your specific objectives after proper consideration of the various contingencies, legal impediments, and taxes involved.
- In the context of farm and ranch or small business operations, an estate plan should facilitate the transition of the operation to the next generation (or the next owner) in a manner that meets the needs/goals of its current owners and addresses the expectations, where appropriate and reasonable, of the current (and/or future) operators.
- Common Estate Counseling Documents
  1. Will
  2. Trust
  3. Durable Power of Attorney
  4. Living Will / Health Care Power of Attorney
- Basic Estate Counseling Terms
  1. Probate - The court supervised administration of a deceased persons probate estate. Definition of probate property is not the same as definition of property subject to transfer taxes.
  2. Intestacy - Legal determination of the distribution of the probate estate of a person without a will.
  3. Fiduciaries
    - a. Personal Representative - Person charged with administration of a decedent's estate.
    - b. Trustee - Holder of legal title over property managed for the benefit of another person.

- c. Guardian - Person charged with supervising a minor child or incapacitated person.
- d. Conservator - Person charged with managing the property of a minor child or incapacitated person.
- e. Attorney-in-fact - Additional person given specific authority to make financial or health care decisions.

#### oBasic Estate Counseling Issues

- Providing for estate owner's security while living (e.g., power of attorney or revocable trust)
- Providing for welfare of surviving spouse after death of estate owner (or second marriage issues)
- Insuring desired disposition of property
  - Lifetime transfers
  - Death transfers
  - Charitable Transfers
- Continuation of family business or family farming/ranching operation
  - Control - who makes the decisions
  - Management - who is empowered to caretake or steward
  - Transition timeline - transitioning control, transitioning ownership, and the timeline for transitioning both
- Tax and cost planning
  - Minimize death taxes -- for 2017 federal estate taxes only apply to single estates with a value over \$5.49 million (need to also consider any applicable state death-related taxes)
  - Minimize estate settlement costs (e.g., probate expenses or costs of a court appointed conservator for elderly persons or minor children who receive bequests)
- Nomination of fiduciaries to manage your concerns if you are unable to do so or after your death

- Other important objectives
  - Establishing guardianships, conservatorships, or trusts for minor children
  - Planning for death (artificial life support, anatomical gifts, and burial instructions)
- Compilation of information needed to prepare the estate design - client questionnaire
  - Identify family facts
  - Estimate value of assets and liabilities
  - Identify asset ownership
  - Understand client's objectives including the desired asset dispositive scheme - asking and answering hard questions honestly and after thoughtful consideration

## ESTATE COUNSELING DEVICES

### ○Asset Ownership

- Single name
- Tenancy in Common
  - Each co-tenant owns an undivided share of whole (i.e., if a husband and wife or brother and sister own real estate as tenants in common, each has one-half of total value in his or her estate).
  - Each tenant's share is subject to probate in their estates.
  - Used to balance estates - equalizing may be important to reduce or eliminate taxes.
- Joint Tenancy
  - Automatic title transfer to surviving joint tenant (“with rights of survivorship”).
  - Not subject to probate - supersedes will and can render estate design ineffective if used improperly.
  - Useful for married couples where estate taxes are not a concern.

- Good for certain assets to permit quick title transfer – home, auto, small bank account.
  - Very common especially among married couples but not always the best option.
- Payable on Death Accounts
    - Bank Accounts.
    - Securities or Brokerage Accounts.
    - Avoids probate, but be careful to comply with dispositive intent and be consistent with established planning. This is generally not a good substitute for estate planning.
- Trusts
    - Divides “legal” and “beneficial” title to property.
    - Trusts are discussed in detail later in the outline.
- Legal Life Estates
    - Divides “present” and “future” ownership of property.
    - Can be complicated tools to use, depending on the applicable state’s laws (i.e., Nebraska’s Unicameral just passed LB 268 in the 2017 legislative session, which law creates liens on remainder interests if transferred to a related party for less than fair market value and the transferor later needs Medicaid assistance for long term care).
- Life Insurance
    - Non-probate transfer of property to contractual beneficiary.
    - Can provide an instant estate - protection of survivors.
    - Can provide liquidity to cover expected estate settlement costs.
    - Ownership of insurance policy dictates the application of transfer taxes. If the insured is the owner of the policy the full death benefit is included in his or her taxable estate for federal estate tax purposes.

- Qualified Retirement Plans (pension and profit sharing plans and IRAs)
  - Nonprobate transfer to contractually named beneficiary.
  - Consists of pre-tax dollars, subject to income tax when received by the retiree or by his beneficiaries following death.
  - Distribution regulated by federal law – potential penalties for withdrawals before age 59 1/2, and distributions must begin after reaching age 70 1/2.
- Corporations, Partnerships, and Limited Liability Companies
  - Give order to transition of family business or possibly even non-business investment assets.
  - Possible income tax advantages.
  - Create convenient units for gifting purposes and provide valuation benefits for estate tax savings.

#### ○ Balancing Estates Between Spouses

- While changes in the estate tax law have made it less critical to balance the assets into individual ownership by each spouse, in some cases, dividing assets between spouses may still be advisable for estate planning to help provide the best transfer tax results regardless of the spouse who is the first to die.
- There are no gift tax or income tax consequences from transferring property between spouses.

### EXPLANATION OF ESTATE COUNSELING DOCUMENTS

#### ○ Wills

- Definition of Will - Written plan for disposition of property after death
- Requirements of a valid will – formalities for execution are important and those requirements may vary from state to state. In Nebraska, a Will is valid if it meets the following criteria:
  - Testator of sound mind.

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- (2) Poor choice except in extenuating circumstances - often ambiguous and improperly prepared.

4. "Standard" Will Clauses

- a. Specific bequests - "I give John my ring"
- b. General bequests - "I give John all my real estate"
- c. Charitable bequests - "I give my church \$1,000"
- d. Residuary bequests - "I give John all of the remainder of my estate"
- e. Trust bequest - "I give (specific, general, charitable or residuary) to my Trustee who shall hold, manage and distribute the property as follows:"
- f. Disposition of tangible personal property - "Laundry list" provision
  - (1) Permitted in some states, including Nebraska.
  - (2) Disposes of personal effects according to separate written list (Written Memorandum).
  - (3) List must reference will and must comply with other statutory requirements.
  - (4) Can alter amend or add to without revising the Will itself.
- g. Nomination of fiduciaries (e.g., Personal Representative and Trustee) and identification of fiduciary powers.
  - (1) Choice between an individual or a corporate fiduciary (bank or trust company). Usually will name successor fiduciaries.
  - (2) The personal representative
    - (a) Powers defined broadly by statute, can be restricted in the will.
    - (b) Bond is usually required for an individual but not corporate personal representatives.

- (c) Duties of a Personal Representative
  - i) File Will for probate
  - ii) Collect and preserve assets of decedent
  - iii) Review and pay claims against estate
  - iv) Make tax elections, file tax returns and pay death taxes.
  - v) Distribute decedent's assets according to terms in will
  - vi) "Close" the estate
- (3) The Trustee
  - (a) Usually involves longer term management of assets. An individual trustee should have some business or investment ability.
  - (b) Estate tax issues may impact the choice of an individual trustee.
  - (c) An individual trustee may or may not charge a fee. A corporate trustee will always charge a fee, but in many cases this is offset by better investment performance.
  - (d) Can name co-trustee, but this can increase the management burden and requires them to cooperate.
- (4) Nomination of Guardian or Conservator for minor children and powers
  - h. Tax payment and apportionment
  - i. Simultaneous death clause, provides a definition of "surviving" the testator.
  - j. Self-proving clause (notarized will) - optional but desirable

5. Codicil - technically an amendment(s) to a will. It is usually easier to just sign a new revised will even if making only small changes.

## B. Trusts

### 1. Definition

- a. An arrangement where one person transfers legal title to property to another person or entity who then manages the property for the benefit of one or more other people.

- (1) Person creating the trust is the "Grantor," "Settlor," "Creator," or "Trustor."

- (2) Person deriving benefits from the property held in trust is the "Beneficiary."

- (3) Individual or corporation holding title to assets in trust is the "Trustee." See prior discussion regarding choice of a Trustee.

- (4) A single person can be the Grantor, a Beneficiary, and the Trustee.

2. Trust instrument is the controlling "contract." The instrument:

- a. Provides for the appointment of Trustee

- b. Describes the time for establishing and terminating trust

- c. Names beneficiaries and determines their rights to the property

- d. Specifies trustee's discretion over income and principal

- e. Gives trustee the power to act as needed to invest, manage, and distribute the property

- f. Courts have jurisdiction over trust issues, but there is no ongoing court supervision.

3. Reasons for establishing a trust:
  - a. Consolidate assets post-death through insurance and retirement plan beneficiary designations
  - b. Provide asset management assistance for Grantor
  - c. Develop and implement plan for managing farm and ranch or small business assets for the benefit of children in the operation as well as children off-operation or for facilitating the operational transition in some other manner
  - d. Provide asset management assistance for survivors of Grantor (children or incapacitated beneficiaries)
  - e. Can be used to avoid probate and save estate settlement costs
  - f. Frequently used as part of a plan to save transfer taxes
4. Revocable Living Trusts (or inter vivos trusts)
  - a. Operative during Grantor's lifetime.
  - b. Used by Grantor to provide management of assets during the Grantor's lifetime, particularly if Grantor becomes incapacitated, thereby avoiding a conservatorship.
  - c. Income and principal paid according to Grantor's direction.
  - d. Usually continues after death of Grantor for survivors or can terminate at Grantor's death.
  - e. Can be part of an estate tax savings plan, but, the mere establishment of a revocable trust has no income or estate tax impact.
  - f. Can be used to avoid probate - if fully funded prior to death.
  - g. May be revoked or agreement may be amended.
  - h. Can fund with a properly drafted Durable Power of Attorney if Grantor becomes incapacitated.
  - i. Used in conjunction with a "Pourover Will" (i.e., major dispositive provisions in trust instrument).

5. Irrevocable Trusts - can come in many forms and for many reasons, usually related to estate taxes
    - a. Irrevocable Life Insurance Trusts (ILIT) designed to remove proceeds of life insurance from the insured's estate for estate tax purposes.
    - b. Trusts for minors - used to facilitate gifting to young beneficiaries for education assistance or other purposes.
    - c. Tax Savings Trusts - other types irrevocable trusts can be used in various other more complex estate tax planning tools such as Grantor Retained Annuity Trusts (GRATs), Intentionally Defective Grantor Trusts (IDGTs), or Qualified Personal Residence Trusts (QPRTs).
  6. Charitable Trusts - an irrevocable trust used to pass assets to charity and also obtain income or estate tax savings
    - a. Charitable remainder trusts (annuity trusts (a fixed dollar payout back to the trust Grantor) or unitrusts (a fixed percentage of the trust assets distributed back to the trust Grantor each year))
    - b. Charitable lead trusts
    - c. Perpetual charitable trust or Private Family Foundations
- C. Durable Powers of Attorney
1. Grants a person the power to act on behalf of Grantor for purposes specified in instrument (person or entity appointed is called attorney-in-fact or agent).
  2. Can be a general power or a power limited to a specific area.
  3. "Durable" means that power extends beyond the incapacity of the creator or until the agent is notified of death. Can avoid need for a conservatorship in some cases.
  4. May provide for funding of trusts in the event of Grantor's incapacity and continuation of gifting program, if specifically authorized in the power.
  5. Usually effective immediately; unauthorized use is always an important consideration.

D. Living Wills - Durable Power of Attorney for Health Care

1. Expression of wishes regarding artificial life support.
2. Can be combined with a Durable Power of Attorney for health care decisions.
3. May include provisions regarding organ donations although that may also be accomplished in other ways
4. May include burial instructions and funeral arrangements.

E. Family Business Planning

- a. Can create voting and nonvoting ownership units (shares of stock or LLC membership units). Creation of nonvoting ownership units allows retention of control even following a transfer of a substantial amount of the equity in the business.
- b. Voting and nonvoting membership units allow use of gift tax discounts for the nonvoting membership units. Transfer of voting membership units between husband and wife (and a small amount to children) can also help to achieve significant valuation discounts.
- c. A shareholder agreement or LLC operating agreement can include language which defines the rights between the owners. Possibly require a member to first offer their interest to other owners inside the family before selling it to a third party. Options to purchase the interest of a deceased owner at death can be included. Alternatively the agreement can give owners an option to require that the other owners purchase all or a portion of their interest at some time.

#### **IV. THE PROBATE PROCESS**

- A. Purposes of Probate
  - 1. Establish validity of a Will (original and narrow meaning of probate)
  - 2. Appoint a personal representative
  - 3. Validate and pay claims against estate
  - 4. File tax returns and pay income, estate, and inheritance taxes owed by the estate
  - 5. Transfer legal title to decedent's property according to terms in Will
  - 6. Protect decedent's interest and interests of decedent's creditors in estate
- B. Court Costs and Probate Fees
  - 1. Court costs are usually minimal for informal probate
  - 2. Attorney's fees - commonly a small percentage of probate estate
- C. Estate Administration
  - 1. Similar to probate but used where decedent dies intestate.
- D. Collection of Property by Affidavit
- E. Marital and Family Property Rights - the following are allowances permitted under Nebraska law and the amounts noted apply in 2017:
  - 1. Exempt Property (\$12,500)
  - 2. Homestead Allowance (\$20,000)
  - 3. Family Allowance
  - 4. Elective Share of surviving spouse

#### **V. ESTATE, INHERITANCE AND GIFT TAXES**

- A. Federal and State Estate Taxes

1. All property owned by the decedent at death, either individually or jointly.
2. Property transferred by the decedent during lifetime if there was any retained interest (i.e. revocable trust property).
3. Life insurance proceeds if payable to the estate or if decedent owned the policy.
4. Retirement plan assets.
5. Tax is based upon fair market value of property at date of death (based on its highest and best use). May elect to value real estate used as a farm or other closely held business based on its actual use rather than its highest and best use under certain conditions.
6. An unlimited marital deduction is permitted for property passing from decedent's estate to surviving spouse.
  - a. Outright transfers to the surviving spouse qualify for the marital deduction, but, passing the entire estate outright to the surviving spouse may increase estate tax upon survivor's death.
  - b. "Terminable Interest" (usually in form of QTIP trusts) can qualify for marital deduction. Decedent must give surviving spouse use of property, including all income, for life. The property can then pass to beneficiaries designated by the first spouse. Property is taxed in estate of surviving spouse if personal representative elects to qualify terminable interest property for the marital deduction.
7. A unified credit against estate tax is available to each decedent. For 2017, this credit shelters the first \$5.49 million of value of each person's lifetime gifts and estate at death. The tax rate on property over this unified credit shelter amount is currently 40%. This credit shelter amount is indexed for inflation in \$10,000 increments, so it will likely increase by some amount each year.
8. In 2011, a concept known as "portability" was incorporated into the federal estate tax law. Under this concept a surviving spouse is able to also utilize any portion of a deceased spouse's credit shelter which was not used when that first spouse died. Theoretically, that allows the surviving spouse to shelter up to \$10.98 million of property value in 2017, assuming all assets passed outright to the surviving spouse when the first spouse died. However, in order to obtain this benefit a federal estate tax return must be filed when the first spouse dies, and the exemption is only available for the exemption of the "last" deceased spouse - so the benefit is potentially lost if the surviving spouse remarries.

B. Nebraska Inheritance Tax (NOTE: not every state has a state death tax)

1. Paid to county of decedent's residence or other county where real property is located
2. Based upon value transferred to another upon death
3. Tax rate and exemption allowed depends on relationship of transferee to decedent. No tax on property passing to a surviving spouse. Tax rate is a flat 1% for transfers to children or other lineal descendants. Siblings and parents who inherit also are subject to tax at that 1% rate. Transfers to nieces and nephews (or their descendants) are subject to a 13% Nebraska inheritance tax, and transfers to more remote relatives or to unrelated persons are taxed at an 18% tax rate.
4. Exemptions are relatively small and applied individually to the recipients of the estate - \$40,000 for parents, siblings, or lineal descendants of the decedent, \$15,000 for nieces or nephews, and \$10,000 for others.
5. The application of these provisions results in a relatively small tax in most estates, but payable in most estates much more often than when federal tax would be due.

C. Federal Gift Taxes

1. Based on fair market value of lifetime transfer of property to another with sufficient consideration.
2. Exclusions from gift tax:
  - a. Annual present interest exclusion of \$14,000 for each recipient (indexed for inflation in \$1,000 increments)
    - (1) Gifts to minors (UTMA and other minors' trusts)
    - (2) Temporary withdrawal rights ("Crummey powers") can be used to qualify trust transfers for the annual exclusion
  - b. Unlimited exclusion for medical or tuition expenses for any individual; only payments directly to the provider qualify
3. Deductions from gift tax:
  - a. Unlimited marital deduction for lifetime gifts between spouses and for certain transfers in trust for a spouse ("QTIPs").

- b. Charitable contributions to approved charitable, religious or non-profit organizations
- c. Unified credit for estate taxes can first be applied to shelter lifetime gifts before gift taxes are payable. This currently allows for up to \$5.49 million of lifetime taxable gifts (i.e. above and beyond the annual exclusion gifts) before any gift tax is actually paid.

D. Generation-Skipping Transfer Taxes

- 1. A separate tax imposed upon any generation-skipping transfer. A generation-skipping transfer is a transfer outright or in trust to a person two or more generations younger than the generation of the transferor.
- 2. A \$5.49 million exemption is allowed to each individual.
- 3. Tax on non-exempt transfers imposed at maximum estate tax rate (i.e., 40%).
- 4. Example: A grandfather establishes a trust for the benefit of his son. The son receives all income and principal of the trust in the trustee's discretion for life. After the son's death the trust assets pass to his children. A generation-skipping transfer tax may result on the death of the son.

## VI. ESTATE PLANNING IN SUMMARY

### A. Estate Counseling

1. Estate counseling should invigorate (not depress) and give additional peace of mind.
2. You must act - laws will benefit only those who use them to their advantage.
3. You must review plans periodically (every year and with every change in circumstances).

### B. Concepts of Planning

1. Estate counseling is complicated and assistance of knowledgeable professionals is needed.
2. Create a team of knowledgeable professionals to assist you in the decision making necessary to transition assets at death. Those professional can include an attorney with experience in estate counseling, trusts, and probate; a life underwriter; an investment advisor; an accountant; a trust officer; and a charitable giving advisor.

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