ESTATE **PLANNING**

An introduction to concepts and strategies

Failing to plan is planning to fail

This cliché holds true for many things, but especially when it comes to your finances.

You've worked much of your life, invested wisely and was able to build a legacy. Surely, you don't want your wealth to fade away when you die. But without proper planning, your goals may be in sight, but remain out of reach.

That is why it is important to have a strong financial strategy, with a beginning, middle and end, and includes manageable short-term goals that can help you to achieve your long-term aims.

And no matter what stage you are living in your financial life, it is never too early, or too late, to learn about and consider the effects of your strategy's final component — wealth transfer. You need to think about your will, trusts, competency issues and transfer — tax consequences and the role they will play to help you successfully meet the financial goals of you and your family.

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What is estate planning?

The objective of estate planning is to conserve and transfer your assets through a logical process that helps reduce legal entanglements and taxes while increasing the wealth transferred to your beneficiaries. Estate planning can include, but may not be limited to, any of the following:

- Will
- Trust
- Power of attorney
- Living will
- Life insurance or other funding source

A common misconception about estate planning is that it is only for the wealthy. While the wealthy may require more involved estate planning techniques, the process is beneficial to everyone who has assets to be transferred upon death. Depending on your age, family status and assets, the process could be:

- No more involved than establishing a will
- As complex as establishing and funding various trusts, and setting in place a variety of tax-reducing strategies

If you are a small-business owner, planning for your business is also an important process. Should business ownership be transferred to beneficiaries or new owners — perhaps current, key employees? Is there a current business continuation agreement in place? Is it funded? If so, how? Will the business assets be liquidated and distributed? Is there a ready market? How would selling the business while you are alive impact your estate?

The New Tax Rules and Your Estate

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 temporarily makes changes to estate, gift and generation-skipping transfer (GST) taxes for 2011 and 2012. It is scheduled to expire at the start of 2013. Here are some highlights.

- Reunifies the estate and gift tax applicable exclusion amount to $5 million
- The generation-skipping tax exemption is $5 million
- The maximum rate for estate, gift and generation-skipping tax is 35%
- Provides a portability provision that makes any applicable exclusion amount remaining unused after the death of the first spouse available to the surviving spouse

If you have an estate valued over $5 million and you fail to plan, your beneficiaries could receive a fraction of what you intended, depending on when your estate is transferred. An effective life insurance strategy can help your estate to transfer as you intend.

Basic estate planning

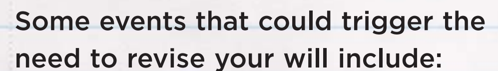
Without a will, intestacy laws will determine the distribution of your assets. Such distribution may not be what you intend. Even with a will, your estate will go through the probate process. If you are a single person with assets of less than $5 million dollars, consider establishing a simple will that distributes your assets as you choose, after debt obligations are satisfied. If you are married, many spouses write wills that leave all assets to each other and establish contingency plans if both husband and wife die simultaneously. Due to the unlimited marital deduction, a surviving spouse can inherit the entire estate without tax liability, depending on the date of death.

The surviving spouse must be a U.S. citizen to qualify for this deduction. If the surviving spouse is not a U.S. citizen, a special trust known as a Qualified Domestic Trust can be used. However, for 2011-2012, if more than $5 million is bequeathed from either spouse's estate to someone other than the surviving spouse, then the estate could be subjected to an estate-tax liability. As with all matters of a tax or legal nature, be sure to consult with your own tax or legal counsel for advice.

If you have children, there are additional considerations you may want to discuss with your attorney such as your wishes for custody of any minors and what the child will receive through a potential inheritance and when. There are other personal considerations you may make when planning your estate, including creating a living will and naming a power of attorney for health care and financial decisions. A living will allows you to make decisions about prolonging your life through various means prior to a time when you may be incapable of making such decisions, relieving your family of the burden of making this decision. Naming a health care power of attorney or health care proxy places medical decisions in trusted hands.

A durable power of attorney is a written document authorizing another person (the "attorney in fact") to act on the principal's behalf. A power of attorney authorizes another individual to enter into and discharge virtually all legal obligations on behalf of the principal.

All wills require an executor. Often people name a family member as executor since such a person is familiar with the family's situation and may be more sensitive to its needs. However, naming a corporate executor may have advantages as well, including expert knowledge and objectivity. Many banks offer this service through their trust departments. You may also name co-executors. Many events can result in the need for updating an existing will. It is generally a good idea to regularly review your will with an attorney to determine whether any changes are needed.



Some events that could trigger the need to revise your will include:

- Moving to a new state
- Death of a spouse or any stated beneficiary
- Marriage or divorce
- Birth or adoption of children
- Change in the value of assets
- Change in asset structure, such as shifting from stocks to real estate
- Any beneficiaries marry, divorce or have children
- Tax law changes

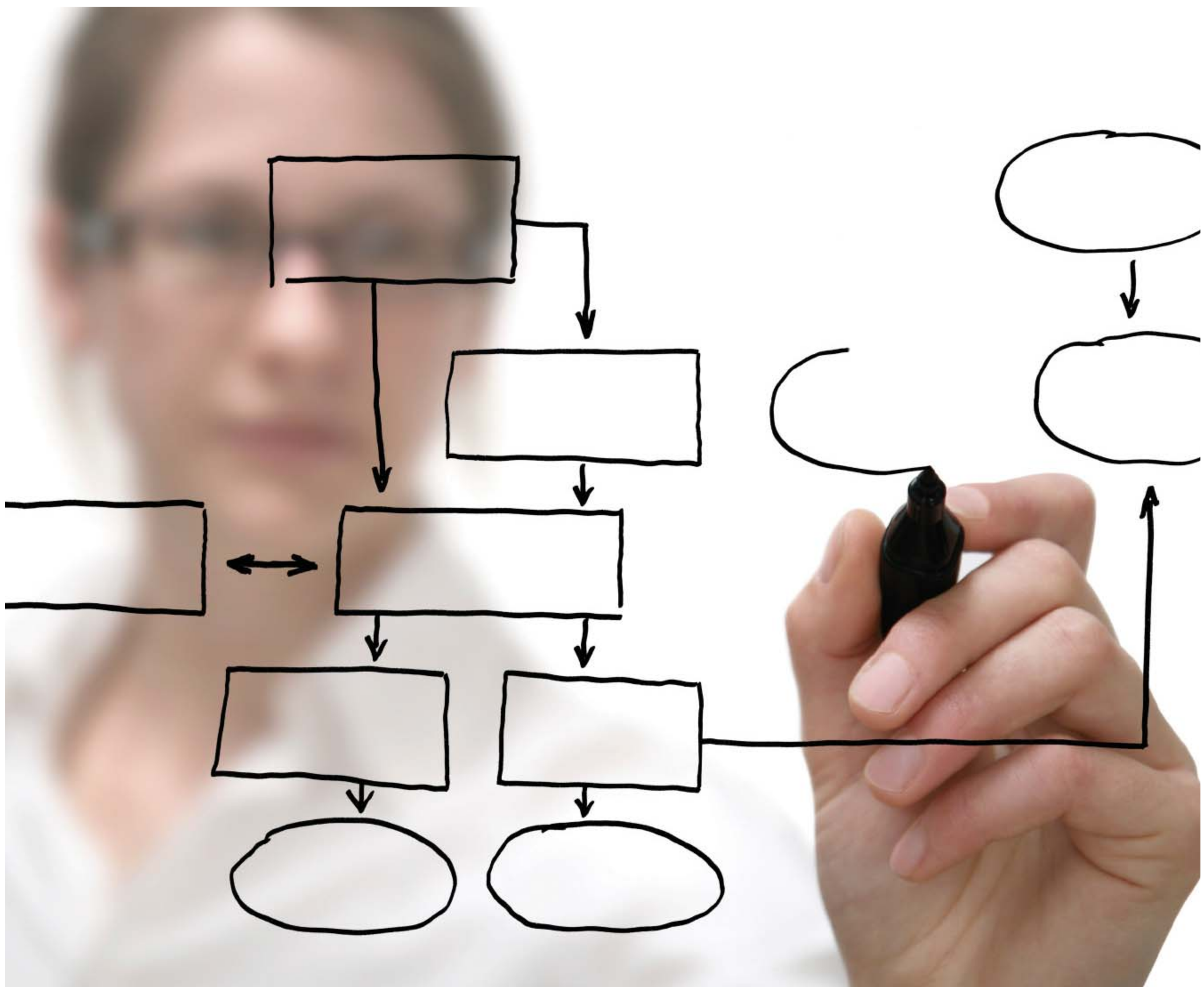
Advanced estate planning

Generally, more advanced estate planning is necessary if your assets total more than $5 million, or whatever the current exclusion amount may be. Be aware that many people underestimate the size of their estates. Your estate includes all of your assets — both liquid and illiquid. This includes your investment portfolio, bank accounts, real estate, business interests, life insurance you own on your own life, qualified plan balances, IRAs, automobiles, jewelry and even collectibles. A proper estate review with a qualified financial professional can help ensure that any tax liability is not greater than you may perceive.

Depending on when you die, estate taxes could still consume up to 35% of your estate. An effective strategy now can save a lot of headaches later. For instance, without proper planning, your beneficiaries may be forced to liquidate assets, potentially at a loss. If there is an estate tax liability, it usually must be paid to the federal government within nine months of death, and state taxes are possibly due even sooner.

Some means of funding your estate tax bill include:

- *Cash on hand:* Some estates may have enough cash available to cover estate expenses.
- *Liquidating assets:* This could include such things as the sale of securities, real estate, collectibles or business assets.
- *Borrowing:* A loan may be secured to cover the expenses, buying time at the cost of interest.
- *Life insurance:* This option uses a portion of the estate now to pay life insurance premiums to provide the death benefit proceeds to cover estate liabilities.



To determine and implement your best options, you may benefit from consulting a variety of professionals. Your estate planning team could include: an estate planning attorney, accountant and financial professional. Sometimes certain professionals can fulfill more than one role. The more involved the plan, the more help you will need.

Estate planning may involve strategies to:

- Effectively plan for and cover estate taxes and other expenses
- Reduce the size of your taxable estate
- Achieve a combination of both

For example, if you are required to take minimum distributions from an IRA, but do not need the income, an effective estate planning strategy could help you to "stretch" your IRA — extend its accumulation period — through restructuring. Your financial professional can help you explore this concept. Another, more common way of reducing the overall size of your taxable estate is through the use of trusts or by gifting.

Trusts

Trusts can help you meet a variety of your wealth transfer goals and avoid some pitfalls. Following are the basics of some common trusts and the estate planning issues they can help address.

Credit Shelter Trusts

"B trust," "bypass trust," "Credit Shelter Trust," "family trust" — by any name, most planners are familiar with this tried and true estate planning device. It allows the first member of a wealthy couple who dies to direct assets equal to his or her estate-tax exemption to a trust for the survivor's benefit. When properly structured, the trust shields assets from being included in the estate of the surviving spouse, potentially reducing the estate tax incurred at the second death.

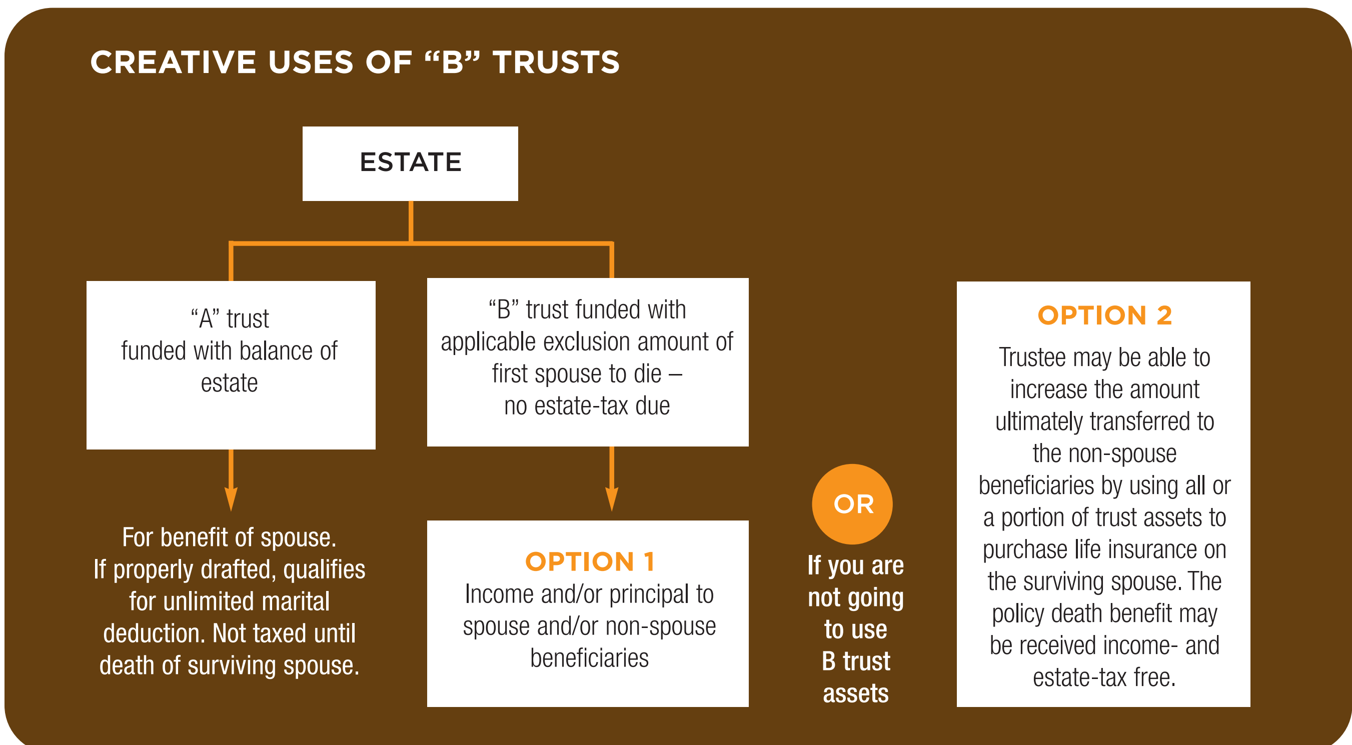
As a result of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"), any unused federal estate tax exemption at the first spouse's death is portable to the surviving spouse. The second spouse to die can now add the unused exemption to his or her own exemption of the deceased spouse, automatically creating a similar tax benefit a Credit Shelter Trust is designed for.

On top of that, with portability the survivor has complete control over all the assets the couple enjoyed together, as contrasted to a Credit Shelter Trust, which limits control based upon the terms of the trust.

However, the future of portability remains uncertain. The 2010 Tax Relief Act was implemented as a temporary compromise, and expires at the end of 2012.

Another important consideration in deciding whether or not to implement a Credit Shelter Trust or rely on portability is that any appreciation on the assets in a Credit Shelter Trust will escape possible estate taxation in the surviving spouse's estate.

Credit Shelter Trust assets may be specifically directed towards the decedent's intended heirs as opposed to portability which leaves the ultimate decision as to who inherits the family wealth in the hands of the surviving spouse. Lastly, the generation-skipping tax allocations are not portable.



Qualified Terminable Interest Property Trust (QTIP)

Couples who use an all-to-spouse will and have children may face an extra challenge if the surviving spouse remarries. Imagine that a surviving wife, for instance, brings her deceased husband's assets to a new marriage. What if that couple then establishes a simple spousal will and the wife predeceases her new husband? The first husband's assets are ultimately transferred to her new husband, diluting or even eliminating any inheritance to the children of the first marriage. The issue can become even more complicated if the second marriage produces children as well. The QTIP Trust is one approach to avoiding this potentially complex situation. Through a QTIP Trust, a person can provide for a surviving spouse's lifetime and define the ultimate beneficiaries of the assets upon the death of the spouse. Thus, a couple can take comfort in knowing that they have provided for a surviving spouse while protecting the ultimate interests of the children, regardless of future relationships.

Revocable Living Trust

A Revocable Living Trust contains instructions for the management of an individual's assets during the individual's life and in the event of disability. It also, similar to a will, contains instructions for the disposition of the individual's assets after death. You should consult with your attorney for the tax implications of naming yourself versus someone else as trustee of your living trust, as well as for any implications of transferring the titles of your assets to the trust. If properly planned, a living trust can reduce or eliminate the time and possible expense of probate, and retain privacy for the family.

The probate process is public, while transfers through a living trust can remain private. Only assets titled to the trust avoid probate. Consult your estate planning team to find out what will work best for your situation.

Irrevocable Life Insurance Trust (ILIT)

If you are planning to use life insurance as a means of funding your estate settlement costs, a properly designed ILIT can remove the death benefit proceeds from your estate for federal estate tax purposes. More on the structure and benefits of an ILIT can be found in the life insurance section of this brochure on page 9.

Naming a trustee

An important component of any trust is naming the trustee. Based on the trust and the goals you want to accomplish, you may or may not be advised to name yourself, your spouse or your children as trustees.

Additionally, professional trustees are available to lend expertise and help avoid any potential conflicts of interest.

Trustee responsibilities include:

- Implementing the trust's terms
- Distributing or reinvesting any returns
- Providing accounting services for the trust, including:
  - Tracking principal and income
  - Filing tax returns
  - Tracking cost biases
- Arranging payment of any of the trust's debt obligations

Gifting

Gifting is one mechanism that can be used to reduce the size of an estate. An individual donor can annually gift up to $13,000 per person, as long as the gift qualifies as a gift of present interest. A present interest gift is one in which the recipient of the gift has all immediate rights to use, possess and enjoy of the property that was gifted. As long as these amounts are not exceeded, no gift tax is payable by the donor. So for example, a husband and wife who want to gift assets totaling $1.3 million could each gift $13,000 of assets to each of their five children in one year, resulting in a total gift by them of $130,000 and repeat this process annually for 10 years (($13,000 gift x 5 children x 10 years) for each of the husband and wife). In addition to the annual gift tax exclusion amount, each individual has a lifetime federal gift tax exclusion amount of $5 million. As long as no individual donee receives more than $13,000 from an individual donor in a calendar year, no portion of the donor's $5 million gift tax exclusion is utilized. However, any use of the applicable exclusion amount during life reduces the applicable exclusion amount available at death. Therefore, if a person makes a lifetime gift of $1 million, that person's applicable exclusion amount at death is reduced by the same $1 million (i.e. it would be reduced to $4 million if the death occurred in 2011 or 2012).

The role of life insurance

Life insurance is a popular and effective tool in helping to meet estate planning goals. Due to the tax-advantaged status of life insurance, it can be an ideal way to fund estate taxes. You use a portion of your assets to pay your life insurance premiums, purchasing death benefit coverage.

When you die, the death benefit is generally paid to beneficiaries income-tax free. The proceeds can then be used to pay your estate-tax bill and other expenses. When compared to other funding options, such as borrowing or liquidating high-yielding assets, life insurance can be an extremely cost-effective means of funding estate expenses.

The death benefit guarantee is based on the claims-paying ability of the issuing company.

Like all components of your estate plan, there are special considerations for your life insurance choice. If you are the owner of the policy, the death benefit will be included in your estate for federal estate-tax purposes. As a result, life insurance purchases for estate planning are typically made through an Irrevocable Life Insurance Trust (ILIT).

The ILIT is the owner and the beneficiary of the life insurance policy. You make gifts to the ILIT to cover the premium costs. The ILIT then purchases the insurance. Since a properly-drafted ILIT is not part of your federal taxable estate, the death benefit proceeds are generally received free of both income and estate taxes. There may be federal gift-tax consequences associated with the funding of an ILIT.

In addition, gifts made to the trust to cover premium payments reduce the value of your taxable estate, and any accumulation of the life insurance account value occurs outside the estate, as well.

A Survivorship Access Trust (SAT) is an Irrevocable Life Insurance Trust that owns a survivorship life insurance policy among its assets. The trust is drafted to allow one insured to access the policy's cash value, without causing the death benefit to be included in the estate of either insured. Through a properly-drafted SAT, the trustee can be authorized to make distributions of trust income and principal to one of the insureds who is the beneficiary of the SAT. At the death of the second insured, the SAT receives the death benefit proceeds income and estate-tax free.

Both loans and withdrawals from a permanent life insurance policy may be subject to penalties and fees and, along with any accrued loan interest, will reduce the policy's account value and death benefit. Assuming a policy is not a Modified Endowment Contract (MEC), withdrawals are taxed only to the extent that they exceed the policyowner's cost basis in the policy and usually loans are free from current federal taxation.

A policy loan could result in tax consequences if the policy lapses or is surrendered while a loan is outstanding. Distributions from MECs are subject to federal income tax to the extent of the gain in the policy and taxable distributions are subject to a 10% additional tax prior to age 59½, with certain exceptions. A MEC occurs when funding for the policy in relation to the death benefit exceeds federal guidelines for life insurance.

Single-Life Access Trusts allow a non-insured spouse beneficiary to enjoy access to a single-life policy insuring their spouse, without causing inclusion of the death benefit in the estate of either.

Plan your plan

It is important to ensure that your goals and strategies are properly aligned in order to make your estate plan effective.

To create an effective estate plan, you must first work with your tax and legal professionals to organize your affairs and be sure your plan will cover all the bases before you implement it. This "planning the plan" will help you ensure that your goals and strategies are properly aligned. A high-level "to do" list for estate planning should include:

- Identification of assets and assembly of all related paperwork: titles, recent statements and tax filings, etc.
- Assembly of any necessary professionals
- Last will and testament
- Living will
- Health care power of attorney
- Durable power of attorney
- Review of potential trust strategies
- Identification of:
    - Estate value and asset types (liquidity analysis)
    - Retirement needs
    - Estate tax liability and funding source
- Analysis of estate transfer goals
- Implementation

By looking at all these aspects of estate planning, with the assistance of your tax and legal professionals you can more confidently implement a plan that works toward achieving your unique goals.

A note on community property states

Several states operate under community property laws. Since community property laws affect the ownership of assets, living — or having lived — in a community property state will come into play in your estate planning process.

In community property states, ownership of a married couple's assets is defined based on how and when the assets were obtained. Generally:

- Assets obtained prior to marriage are owned as separate property by the spouse who obtained them
- Assets obtained by gift or inheritance during marriage belong to the person who received them
- Other assets obtained during marriage are owned equally by each spouse, regardless of who obtained them

The rules of community property are extremely important when calculating estate tax liability. When a person living in a community property state dies, that person's estate consists of 100% of his or her separate property and 50% of the value of assets owned as community property.

If desired, many community property states allow husbands and wives to enter into agreements that transfer property from individual or community ownership to the other.

Your financial professional can let you know which are currently community property states. If you are a community property resident, as in most estate planning situations, professional advice can help you achieve your goals within your individual circumstances.

Not a "one and done" situation

Estate planning is not something you can do once and then forget about. Your life can change, tax laws change, and tomorrow's needs may not be the same as today's. Your estate plan is too important to simply sit back and watch it become obsolete. It is a good idea to conduct an annual review of your entire plan with any professionals you have involved.

However, certain events may cause you to revisit your plan more frequently. Such things include:

- Significant increase or decrease in estate value
- Birth or death of a family member
- Marriage or divorce
- Change in job or job status if you are not yet retired

Proper estate planning will be flexible enough to be able to adjust to change, but it is important that you review your plan regularly to identify what and when any action may need to be taken.

Glossary

Applicable Exclusion Amount: The value of an estate that the federal government allows to be transferred without federal estate/gift taxes. Estates/gifts valued above the applicable exclusion amount are subject to transfer taxes.

Community Property Laws: Define the ownership of assets between husband and wife based on how and when the assets were obtained. Generally, assets obtained before marriage are owned as separate property by the individual. Assets obtained during marriage, except by gift or inheritance, are owned equally by the two. Effective in several states.

Credit Shelter Trust: Legal document designed to receive one spouse's applicable exclusion amount at death and remove the value from the surviving spouse's estate.

Durable Power of Attorney: Document authorizing someone you select to act on your behalf, even if you become incapacitated.

Executor: Person and/or corporation named to execute the terms of a will.

Gift and Generation Skipping Transfer Taxes: Gifts by an individual above a certain amount are subject to a federal gift tax. If the gift is to an individual more than one generation removed, it may also be subject to the generation-skipping transfer tax. Gifts by couples can be combined to essentially double the annual gift exclusion.

Health Care Power of Attorney or Proxy: Person legally empowered to make decisions regarding your medical care should you be unable to.

Irrevocable Life Insurance Trust (ILIT): An irrevocable trust that owns life insurance, thus removing proceeds from the insured's estate.

Living Will: Legal document that states your preferences for life prolonging medical treatment should you become incapacitated.

Probate Court: Legal proceeding for assigning and/or validating the distribution of a deceased person's assets.

Qualified Terminable Interest Property Trust (QTIP): A Qualified Terminable Interest Property Trust is a Marital Trust that allows someone to provide for a surviving spouse while protecting the inheritance interests of children.

Revocable Living Trust: Legal document that can help distribute certain assets without going through the full probate process.

Survivorship Access Trust: An Irrevocable Life Insurance Trust that owns a survivorship life insurance policy among its assets. The trust is drafted to allow one insured to access the policy's cash value, without causing the death benefit to be included in the estate of either insured.

Unlimited Marital Deduction: The unlimited marital deduction allows for estate-tax free transfer of any size estate from one spouse to another upon death, assuming both are citizens of the United States.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act")

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act") reinstated the federal estate tax and generation-skipping taxes and reunified the estate and gift tax basic exclusion amount. Under the Act, estate, gift, and generation-skipping transfers are taxed at a maximum rate of 35%. The individual basic exclusion amount for estate, gift and generation-skipping transfers is $5 million, subject to an inflation adjustment in 2012. An individual's basic exclusion amount for estate tax purposes may be increased by the unused basic exclusion amount of a deceased spouse. The Act expires at the end of 2012, at which time the estate, gift and generation-skipping transfer tax exemptions will be reduced to $1 million (the generation-skipping tax exemption is indexed) and the maximum rates will be increased to 55%.

The uncertainty regarding how the Act might be modified, underscores the importance of seeking guidance from a qualified advisor to help ensure that your estate plan adequately addresses your needs and those of your beneficiaries under all possible scenarios.

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