

Chapter II

Estate Planning and You

Consider This Situation

Harry, Betty, and their four children, ages 17 through 29, live together. Harry and Betty have worked in a farm business for over 35 years. They started by farming the 200-acre main farm and implemented a forest management plan for the 85-acre woodlot, all of which Harry inherited from his parents when they both died in 1969. A few years later, Harry and his brother, Joe inherited a parcel of land as the sole heirs of their older brother, Dick. Dick's property included an additional tract of 150 acres, 75 acres of which was wooded and located adjacent to a real estate development. All of these wooded acres included mixed hardwood species of an average age of 50 years. The average value of the wood on the wooded acres is \$1,500 per acre.

After Dick's death, Harry took over farming operations on Dick's land and began to examine the potential opportunities in the additional wooded acreage. Having managed forest acreage to achieve its maximum potential, Harry began to include the added acreage in his current plan.

Joe had no interest in the operations on Dick's property as he was a successful businessman involved with his own business.

Residential development now completely encircles the main 200-acre farm and the additional 150-acre parcel. As a result, land values have soared upward. Harry has been approached by several people about selling the farm, but he graciously expresses no interest in selling. Developers are particularly interested in the wooded portion of the tract, as it provides an ideal setting for a wooded residential development. Three years ago the combined value of the main farm and woodlot and Harry's interest in the additional parcel was \$3,165,000. The 150-acre parcel alone was worth \$1,600,000.

Harry and Betty own the main farm and additional properties jointly, although the deeds to the properties list Harry's name alone as owner. The 150-acre parcel was distributed to Harry and Joe after Dick's death and ownership of the land passed to them through Dick's estate. In addition to the farmland, Harry and Betty accumulated over \$900,000 of machinery, livestock, and equipment in their farming operation.

Harry prepared a will thirty years ago that transfers all of his property to Betty after his death. Harry also assumed one or more of his children would return to farm and keep the family tradition alive. Family tradition was something that made Harry very proud. He wanted the land to stay in the family and he didn't view himself as the person who should make decisions about its future.

Harry and Betty's oldest child works on the farm having earned a degree in dairy science with a minor in forestry. This child has big plans for the future of the farming operation. The second oldest child travels throughout the country as a public accountant for a national firm. This child

is not interested in the production side of agriculture, but is very aware of the value of Harry and Betty's holdings. The third oldest child graduated from college this year and is deciding what the next step should be toward some type of a professional career. The youngest child is a high school senior who wants to go to college to earn a degree in wildlife science.

Harry and Betty do not spend much time wondering what will happen to their property if either or both of them die. Why should they fill out information about their property and pay outrageous fees to lawyers or others who are only interested in finding out what they own? It's none of their business! At one time Harry considered a partnership with the child who is on the farm, but nothing was done about it. Harry didn't think the child was ready to enter a partnership, and she knew she wasn't really interested either.

Harry and Betty carefully guard their property because they are concerned about their financial future. Medical care costs are rising and it is difficult to set aside a specific amount of property to feel secure about their future. Giving their property away is not a subject that either want to discuss. Harry and Betty work hard for what they have. Why give property away to someone who could waste it, or squander its value?

Neither Harry nor Betty have an accurate idea of the financial value of what they own. They consider only their bank accounts and certificates of deposit as available funds. In these accounts they have a total of \$65,000, in both their names.

Harry never thought much about insurance or retirement planning and has less than \$20,000 of life insurance protection. His income from farming and timber sales is modest, but Betty and the kids are taken care of to his satisfaction.

Harry and Betty are concerned about the future of the farm and timber business and the value that the growing trees will bring in the next few years. The children are concerned about these issues as well. There has been only one family discussion about the businesses and what Harry and Betty would like to see happen to them when they are gone.

A. Overview and Purpose

The issues presented in the above situation provide important questions that will help you understand what is involved in estate planning. For example, what happens to the property owned by Harry if he dies suddenly? What are the tax impacts of Harry's death? Which taxes apply? Who pays the tax? When is the payment due? How will Betty and the kids get along after Harry's death? What will happen to the kids if Betty dies suddenly? In this chapter we will explore the concept of estate planning and the issues it creates.

B. Lesson Objectives

When you have successfully completed this chapter, you will be able to accomplish these objectives.

1. Define the meaning of the term “estate planning.”
2. Describe the importance of setting family goals and objectives as part of the estate plan.
3. Describe the tools of estate planning.
4. Identify the members of the estate planning team and the role they play as team members.

C. What is Estate Planning?

Estate planning is defined in several ways. In one sense, it means maintaining a continuous inventory of what you own and owe and your plans for disposing of your accumulated property if you die. In another sense, it means the process that you apply in planning for the transfer of property after your death. In a third sense, estate planning also involves important decisions you can make that have lifetime impact or significance. Some of the other important lifetime decisions that don't involve the transfer of property, but that are made in the estate planning process include giving someone authority to deal with your property if you become disabled or incapacitated.

In recent years much interest has been shown in the right of an individual to personally decide whether medical care and services should be provided in the case of a terminal illness, disease, or injury. What if the person is incapable of communicating their personal desires concerning care when the condition is diagnosed? In many states laws in place allow individuals to write their own wishes and instructions concerning medical care in cases of irreversible medical problems. These written instructions are known by several terms, including *advanced directive concerning medical care* or in some states the term *living will*. In states where this issue is addressed by legislation, specific procedures and choices may apply to individuals who want to exercise their personal right to decide.

A second issue that is related to an individual's disability in matters involving their property is their right to designate someone to have authority over their property. This transfer of authority is known as *a power of attorney*. In this process an individual who is fully competent to manage property and make decisions designates another person, in writing, to act in their behalf in performing specific duties regarding their property. The authority must be specifically described and can include *the power to authorize a person's admission to a medical or nursing facility or authorization of specific medical procedures and treatment*.

To avoid any future disagreement or confusion about the impact of disability or incapacity on this transfer of authority, the person who designates the other person can specify that any later occurring disability or death has no effect on the grant of authority created by the power of attorney. Documents that make this statement are known as *durable powers of attorney*.

These are just a few examples of lifetime decisions that do not involve the transfer of property. Each example identifies an opportunity to use the planning process to make an important decision. Other lifetime decisions, such as the choice of job or profession, where to live, or how to invest your money, are concerned with accumulating assets or establishing a steady stream of income. In comparison, estate planning decisions look beyond the accumulation of property to the question of what happens to the property you accumulate after you die.

Among the three definitions of estate planning are several key points. Estate planning is a process rather than an act that ends in a single, final event. Estate planning involves many issues that change over time. The individuals to whom the property will be distributed change as families pass through their cycles of lifetime development. Laws that influence choices regarding ownership of property, inheritance and estate tax, business organizations, marital property rights and the status of family members often change. Law changes may present new opportunities for the estate plan. Therefore, it is wise to review the plan from time to time and ask if it still provides for the efficient and effective transfer of property.

D. How Does an Individual or Family Plan an Estate?

Since an estate plan involves many important decisions, the best way to start the plan process is to set individual or family goals or objectives you would like the plan to achieve. These goals or objectives are the guiding light you will follow throughout the process. As choices or alternatives are presented, ask yourself, "How do these choices or alternatives contribute to or detract from accomplishing the goals or objectives I've set?" The goals become the measure against which new choices are evaluated.

Goals and objectives can be individual, family, or a mix of both. Involving family members in a plan in which they play an important part serves to increase the likelihood that the plan will be a success and the family members will perform their roles effectively. Being in the dark about such matters creates a significant risk of misunderstanding or overlooking important issues the plan is to address.

What kinds of goals and objectives do families choose in their estate plans? The answer to this question is really quite broad for each estate plan is a personal decision about individual situations. Although the decisions are personal, a number of general points can be made about them. These include the determination of personal goals; handling of a family business; and property transfer and reduction of attendant state and federal taxes.

First, most estate plans involve a series of personal goals, such as providing financial and personal security for a financially or personally dependent family member. Within families, some individuals have greater needs than others and a plan goal should address those needs. Other individuals may need to have a dependable, regular source of income, either before or after retirement. A plan can address several ways to create an income-producing fund and management of the fund to improve its income performance.

Other individuals select the goal of benefiting people or organizations that are outside of the family. Organizations such as charities, hospitals, churches, and private schools depend to a large extent on the generosity of other people to support their activities, programs, and physical facilities. The tax laws provide an incentive to those who are interested in pursuing this approach and specific benefits to those who make such contributions.

Another example of a personal goal is the issue of promoting family harmony and avoiding those things that tend to disrupt harmony. An issue that many people find particularly distressing has

to do with how to treat children. Should all children be treated equally in the distribution of a parent's property or should parents provide for a distribution that recognizes the special contribution of one or two children and treats them differently from other children? If a parent views this pattern of property distribution that recognizes a special contribution as a fair method of providing for the children, the other children who do not receive the special treatment may question the situation. Earlier, the suggestion was made to involve the family in estate planning decisions. This is for the purpose of explaining why decisions are made rather than permitting family members to influence decisions for personal reasons.

A second set of common goals involves a family business and how the plan treats it. For example, a family business that has existed for generations has quite a bit of incentive to find ways to continue the business. Decisions directed at continuing the business must find family members capable of and interested in continuing the business. If maintaining the family business can be accomplished by distributing the property to only one or two children, other children may feel angry about their sibling's good fortune. Explaining why this decision is made can avoid negative reaction and dissention.

After finding the family member who will continue the business, the next question is, how does one provide for the transfer and meet the expenses of completing it? A great deal of that expense involves inheritance and estate taxes that arise from the transfer. Finding ways to avoid the threat of having to sell the business to pay the required inheritance and estate taxes is the central objective of the plan.

A third set of common goals involve the financial issue of reducing state and federal taxes and the expenses associated with the property transfer. As will be seen in later chapters, property is potentially subject to several different taxes as it is transferred after the owner's death. Since most of us do not want to pay more tax than necessary, opportunities to save taxes are attractive goals for people to set. Within the tax laws and regulations are several important opportunities to accomplish the goal of reducing taxes if the property being transferred is of a particular type or kind and requirements to use the tax saving maneuver can be met. Estate planning goals focus on evaluating the tax-saving maneuver if applied to the owner's situation and ensuring that requirements for application are met. Not all estates are able to take advantage of tax savings maneuvers. The eligible groups are often small and the requirements can be complex. Therefore, the process should involve careful analysis and decision making.

In reviewing these common estate planning goals, keep in mind that they only illustrate common goals. Some estates will have aspects of all three, but effective plans can also be developed that have different objectives. Each estate plan should reflect the personal situation of the property owner and the personal goals and objectives he or she chooses for the plan. Plans vary from individual to individual and family to family.

Size of a family affects the question of whether a parent treats all children equally or fairly. Providing for the transfer of land among five children, only one of whom wants to continue managing the timber, is substantially more difficult than distributing it to two children, both of whom share the same goal. If the plan is developed before the children are at the level to decide,

the parents' desire to see the business continue may have to be accomplished another way or delayed until a future date.

The value of assets directly involves the various tax statutes that apply to the transfer. Having substantial property to pass to others increases the risk that taxes will take a portion of the property before it gets to the intended beneficiary. Planning that recognizes the tax threat and employs planning strategies to reduce the threat has very specific goals and objectives that reflect individual situations.

The type of assets involved in an estate affects the estate's ability to liquidate its assets to pay bills and expenses and make distribution to the beneficiaries. If one of the assets is a family business, a decision to maintain the business faces the practical and tax problems described above. If the decision is to sell the business, important questions about its value to a potential buyer must be answered. Also, the practical problem of continuing operation of the business until a buyer is found is driven by the fact that the value of an active, on-going business is generally higher than one that is out of business. Closing the business while a successor is being sought may result in a rapid decline in business value. In keeping a business going after an owner's death, another problem is the authority of the person running the business. To maintain an active business, the business owner should direct his or her personal representative to do so, or the representative should seek court approval to do so when the owner has not made clear instructions to the representative.

E. Estate Planning Advisors and the Tools They Use

In the previous discussion we touched on a number of problems relating to estate planning issues. To whom would a person go to get all of the information needed to deal with these issues? The answer is found in the concept of the *estate planning team* and the tools used by the team members.

For matters that involve legal issues such as preparation of a valid will or trust agreement to transfer property after death, lifetime gift transfers or advice on property ownership forms that transfer property and save taxes, a person consults an attorney whose practice and experience is in the area of estate planning. The practice of law is complex and many professionals limit their practice to specific kinds of cases. As a result, their knowledge and experience centers on limited subjects. Selecting the right advisor who is experienced in the area you need is an important decision.

Information about *income, estate, or gift tax* questions may come from an accountant or attorney who has the proper background. Since many decisions have lifetime as well as post-death impact, the advisor must be able to coordinate matters in order to avoid an unexpected and detrimental result. Tax advisors use the tools of tax planning strategies and opportunities to minimize taxes or lessen their impact

The *trust*, as a tool in estate planning, involves a transfer of property to a trustee along with a detailed description of the trustee's duties and obligations to the beneficiary of the trust.

Important decisions in the formation of the trust include selection of the trustee and defining the trustee's role in the trust agreement.

In law, a trustee is described as a person who acts as a *fiduciary*. Exercising this authority is a serious matter for which the trustee bears substantial responsibility for decisions made. Operation of a trust with a professional trustee raises important issues concerning the trust agreement and cost of the trustee's services that should be explored by property owners before decisions are made.

Information about trusts as a life-time or post-death device to accomplish planning goals and the role of a professional trustee is available from banks and trust companies whose charter gives them the authority to act as a trustee for another person. Their experience makes them particularly valuable in providing information on the creation and operation of trusts, as well as their cost.

Other members of the estate planning team include advisors whose expertise and skill is in particular areas, such as insurance, investments, or business organization management and operation. The tools used by insurance and investment advisors are insurance and investment products applied to estate planning situations. Product choices have grown dramatically over recent years, and the deluge of new products creates the need to seek out advisors who are aware of and knowledgeable about the range of new products and the functions they serve. Business organization consultants offer advice and recommendations on the organization and operation of alternative business forms such as partnerships, limited partnerships, corporations, tax-option corporations and joint ventures. As alternatives to evaluate in a particular setting, these structures provide opportunities to plan for business changes.

One part of the estate planning team that doesn't bring knowledge or expertise to bear on planning choices, but does play an important role nonetheless, is the family. As the primary group to benefit from property transfers, family members help to define the goals and objectives of the plan. Certain family members will also play important roles in implementing the plan. Their strengths and weaknesses may well influence the plan in significant ways. Understanding the reasons for plan decisions is another role for family members to play in implementing it. Although not the final decision maker, the family should be involved in shaping goals and objectives and supporting the plan that is put in motion. If family harmony is an important plan objective, it may be difficult to gain the harmony without family involvement.

F. Student Exercises

1. The concept of estate planning has several different aspects to it. Which one of the following statements does not describe an aspect of estate planning?
 - a. Planning for the transfer of property after you die.
 - b. Maintaining an inventory of what you own and owe.
 - c. Designating someone to act on your behalf if you become disabled.
 - d. Selecting the investment that offers the highest rate of return on your funds.

NOTE: The following four questions may have more than one correct answer.

2. The estate planning team refers to those individuals who can provide information and assistance to people who are interested in planning their estates. Of the following individuals, who would be part of the estate planning team? Please circle the letter(s) that references those people who would be part of the team.
 - a. Physicians
 - b. Bank Trust Officers
 - c. Bank Loan Officers
 - d. Tax Accountants

3. The tools of estate planning are the devices and techniques that planners use to create plans to achieve the goals of property owners. Which of the following statements describe the tools that could be used in an estate plan? Please circle the letter(s) that correspond(s) to those items that you consider to be tools.
 - a. Wills
 - b. Trust Agreements
 - c. Insurance Plans
 - d. Partnerships and Corporations

4. Estate planning involves making decisions that help to achieve individual or family goals. Which of the following statements would not be considered an individual's personal goal in an estate plan? Please circle the letter(s) that correspond(s) to the goal(s) that you feel are not individual personal goals for your estate plan.
 - a. Improving physical fitness
 - b. Improving nutrition and weight
 - c. Helping someone who is in financial need
 - d. Assuring that children will have funds available to further their education

5. Which of the following events should prompt a person to review their estate plan? Please circle the letter(s) that refer(s) to such an event.
 - a. Birth of a child
 - b. Winning a multi-million dollar lottery
 - c. Changing jobs
 - d. Selling property