

## ***Your Will: Will It Do What You Want It To Do?***

- **The Big Tasks, The Big Dollars**
- **Will Legalities**
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- **Trust Options and Custodial Accounts**
- **Tax Alerts and Cautions**
- **Family Information Roadmap**
- **Your Executor/Executrix**
- **Preparing a New Will**
- **Avoiding Life Insurance Mistakes**
- **Talking to Your Advisers**

## Avoid These Big Mistakes

- Do not assume that all of your assets and life insurance should go to your spouse or that all assets should be jointly owned. Check with both your insurance and estate advisers.
- When transferring or giving assets, do not maintain any control over those assets (i.e., incidents of ownership) or the value of the assets may be included in your estate and the income taxed to you personally.
- Do not enter into *irrevocable* transactions without the advice of *two* experts.
- Do not keep the original copy of your will or trust agreements in a safe deposit box. Your heirs may need a court order to open the box after your death. Keep a copy at home and have your lawyer hold the originals.
- Do not treat your estate, insurance, and retirement vehicles separately. Take a broad view and look at them as a total package. For example, you don't want an insurance policy naming one child as beneficiary undermining your will's intentions to treat all children equally.
- Do not gift or place so many assets into trusts that you are left with insufficient cash or liquidity to support yourself and spouse in your retirement years.

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**The goal of good recordkeeping is to assure that you and your family receive everything to which you're entitled while protecting your assets and deductions.**

## The Big Tasks, The Big Dollars

You have built a sizable estate to provide for your heirs after your death. Now you have to make sure those assets get to your intended heirs with a minimum of taxes, legal complications, and administrative confusion.

This **Resource Report** focuses on the main vehicles for settling your estate: your will and life insurance — your will because it will determine how your assets are distributed at your death and your life insurance because the death benefit probably will be the most liquid component of your estate and the one your family members will rely on most to pay their immediate living expenses after your death.

It is estimated that 90% of the people in this country do *not* have legally valid or up-to-date wills. But a will must be even more than current and valid — it must be effective. That means it must do what you want it to do in the way you would have done it. Keep in mind also that when your estate is being settled, you won't be around to control the management and distribution of its assets. That's why the time to control your estate is now. As the owners of the assets, you and your spouse have *complete authority* to determine who is to receive which assets, in what form, and on what schedule.

A comprehensive plan drafted now will give you peace of mind that your will and estate plan reflect your intentions and that they are structured to minimize the tax liability for your heirs so that they receive the greatest possible percentage of your assets.

Review carefully this **Resource Report** and then meet with your advisers to be sure that what's "in writing" reflects your current wishes. Of particular importance are the answers to the following questions:

- Will my assets be distributed after my death as I want them to? Have there been major changes in my family, financial situation, or business since my last will was prepared? Has it been updated for all recent tax law changes?
- Who are the *current* owners and beneficiaries of my insurance policies:

me, my spouse, children, business, pension plan, or insurance trust? Based on my circumstances today, who *should* be the owners and beneficiaries of the policies?

- Are all my estate plan components coordinated: my will, life insurance policies, assets, cash, any trusts, succession and buy-sell agreements? You don't want any intended heirs overlooked or treated unfairly and you want the plan as a whole to reflect your actual intentions.
- If I own part of a business, have I effected a buy-sell agreement with other owners or executives that takes effect on my retirement, disability, or death? Is there a written plan to assure the continuity of the business?
- Is my executor/executrix sufficiently knowledgeable to handle business and investment decisions? Does that person know my intentions and the location of all necessary legal documents?

Remember, the administration and settlement of an estate, particularly if it includes an operating business, is not an easy task. Your and your spouse's advance planning will go a long way in reducing the burden of that task, saving taxes, and assuring a more orderly transfer of your estate/assets.

This important **Resource Report** will guide you through the basic legalities, records, and precautions involved in the task and alert you to potential mistakes.

**It is critical that your will, trusts, life insurance policies, and beneficiary designations be coordinated with each other.**

# Your Will

Your will should reflect your *current* family and financial situation. Both your and your spouse's wills should be reviewed anytime there is a change in your family (e.g., birth, death, marriage, divorce, etc.), a significant increase or decrease in your life insurance, a move to another state, a change in your total assets (e.g., you receive an inheritance or proceeds from the sale of a home or business), or new legislation which changes the taxation of estates, trusts, gifts, or life insurance.

## Basic Legalities

**1. Codicils.** Codicils are amendments to a will.

*Problem.* Handwritten changes, erasures, additions made in the margin of a will, or the inking out of paragraphs or names can open up the will to legal challenge and even void the will. *What to do:* Have the codicils formally added and witnessed according to the same rules you followed in drafting the will itself. *Important:* If there are many changes, consider drafting a *new* will.

**2. Oversights.** If you are deliberately ignoring a particular relative or assumed heir in making your bequest, you should consider making it clear in the will that the oversight is intentional and not inadvertent.

*What to do:* Write a letter to your attorney explaining that a specific individual was not named in the will and then indicate the reason. The best way is to make the letter part of your will. *Example:* I am not leaving any assets to my son, John, because he has received other assets from me.

**3. Clarity.** If you are making specific bequests to your children or grandchildren, *name them*, so there is no misunderstanding on who is to get what. (Don't use the word "children" without defining it and alert your lawyer to adopted and stepchildren.) If you're leaving assets to other relatives, specify who is to get that asset and what happens to those assets if that relative dies before you.

**4. Challenges.** If you are seriously ill when you sign your will, have your doctor present when you execute the will to attest to your competence. That way, disappointed relatives, business partners, and other individuals are less likely to

challenge it.

**5. State laws.** States have different requirements for a valid will. Be certain that the witnesses don't have a conflict of interest. For example, a beneficiary of your estate might not be able to qualify as a witness to your will without losing his or her bequest. Also, most states require that a specific portion of any estate must go to a spouse and/or children. *Two more alerts:*

- *Move to a new state:* The will drawn in the state you left may be partly or completely invalid in the state in which you currently reside. Be sure your will conforms to the laws in your *new* state of residence. *Important:* A move from a community-property state to a common-law state — or vice versa — can definitely signal a revision in your will.
- *Purchase of property in another state:* Also be aware that complications can arise if you own property in two different states because two sets of laws and taxation may apply. In addition, if you own homes in more than one state, make sure it's clear which home is your personal residence, i.e., the same as on your tax returns.

**6. Size of your estate.** If your intention is to equally divide your estate among heirs, consider indicating their shares as percentages rather than dollar amounts. *Reason:* Your estate could grow substantially in value between the date your will is signed and your death. Thus, an intention to leave one-fourth of an \$800,000 estate to each of four children could be subverted by a will that gives each a \$200,000 bequest when the estate has grown from the original \$800,000 to \$2 million.

*Alert:* Specific bequests in a will or codicil usually are payable *before* residual bequests. For example, a specific bequest (say, to a friend or charity) of "\$25,000 in cash" is paid before the heir (say, your daughter) who is willed "25% of your assets." Consequently, your children or other primary beneficiaries may suffer if the specific bequests take a larger portion of the estate than was originally intended.

**7. Asset ownership.** If you own assets with another person, say your children, spouse, or business partner, check the meaning of the *joint ownership* language with your lawyer. Typical terms are: tenancy in common, joint tenancy with right of survivorship, and tenancy by the entirety (between spouses). Each

of them has different effects on the death of one of the owners.

- *Tenants in Common*: Each individual owns an interest in the property, usually 50%. On the death of the first owner, the 50% interest *does not pass automatically* to the surviving owner. It is distributed in accordance with the terms of the decedent's will or, if there is no will, by the laws of intestacy in the decedent's state of residence.
- *Tenants with Right of Survivorship*: On death, the decedent's 50% interest in the property passes *automatically* to the surviving joint owner, irrespective of what the decedent's will indicates.
- *Tenants by the Entirety*: A special form of joint tenants created under the laws of many states where right of survivorship is *automatic*. It is always limited to spouses.

Since state laws control the meaning of property ownership terms, checking out the *joint ownership* wording is particularly important if: (a) you have moved to a new state since purchasing the asset in joint name *and* (b) the joint asset is located in a state other than the state in which you're currently a resident. The greater the value of the asset owned in joint name, the more critical it is that you check the joint ownership wording and applicable state laws.

## **Distribution Mistakes**

You want your will to distribute your assets as well as specific gifts the way you intend to have them distributed to your spouse, children, grandchildren, and others. That might not happen if you don't take the time to understand the complex legal terms used in will documents and, in particular, the use of the words: *Issue*, *Per Stirpes*, and *Per Capita*. The use of any one of these terms will have very different effects on how your estates' assets are distributed and the percentage allocation received by each family member or group, e.g., your children.

To help you discuss these terms with your lawyer, here are some definitions.

**Issue** — The term "issue" refers to the *direct* descendants of a deceased taxpayer: children, grandchildren, great grandchildren, etc. It does not include a spouse, but, depending on state law, it usually includes adopted children.

**Per Stirpes** — Distribution of an estate’s property so that the *surviving* descendants receive what their immediate ancestor (e.g., a deceased mother or father) would have received if she or he had been alive at the time of the estate owner’s death.

**Per Capita** — Distribution of the estate’s property so that *all* surviving descendants (children, grandchildren, etc.) receive *equal shares* of the property, regardless of generation. Thus, a grandchild or even a great grandchild would receive the same amount as one of your children.

Discuss these terms with your lawyer; you want your estate’s assets distributed the way you intend. And that intent may be *very different* today than when you originally signed your will. A new will or revision of your old will may be in order.

## **Plan for Inability to Make Decisions**

A formal will is not sufficient protection. It should be supplemented by other documents that provide protection in case of disability, incompetence, or any inability to make your own decisions on both personal and business matters.

Discuss with your advisers which of the following documents you should complete, sign, and put in a safe place for easy access by your family.

- *Living Will* — a set of instructions relied on by health-care providers in determining the level of extraordinary life support they will provide in the event of terminal illness or injury.

- *Health Care Proxy* — appointment of an agent to make health-care decisions for you in the event you become unconscious, are found incompetent, or are otherwise unable to make the decisions yourself.

- *Durable Power of Attorney* — appointment of an individual to manage the assets in your name in the event of your disability or incompetency. But be careful; a *power of attorney* can empower that individual to write checks against your account, sell and buy assets, and make other business and legal decisions on your behalf. Consider appointing two people, neither of whom can act alone.

- *Living Trust* — a document which spells out your wishes regarding your assets, estate, and medical decisions. It's a "living" trust since it can be changed or revoked *at any time* while you're alive. Individuals use a living trust to minimize or avoid the costs and delays associated with the probate process and to appoint a legal guardian for minor children. More on living trusts later.

- *Guardianship* — if you and your spouse die simultaneously or within a short time of each other or your spouse has already passed away and you didn't provide for a guardian for your minor children, the court will appoint one to raise them and administer the income and assets received by them from your estate. Also, the children may be wards of the court pending a decision. To prevent this from happening, indicate your intentions in your will or living trust.

- *Interim Management Agreement* — a document that takes effect on the death or disability of a business owner and names an individual or firm to manage the company until the estate is settled or the disability ends.

Discuss these documents with your spouse and lawyer. All of them provide important protection and can be changed or revoked at any time.

*Check state laws:* For your information, some states have enacted laws, called *Default Surrogate Decision Making Statutes*, which specify the priority of individuals who can make decisions for you if you become incompetent. In that case, state law would determine who has control over decisions for you and could take precedence over the documents described above. Consult with your lawyer regarding the statutes in your state.

## **Trust Options**

Shifting assets and taxable income from yourself to your children or other family members through a trust can save taxes, provide more income for your

family, and lower the value of your taxable estate. But be careful. Trusts — because of the federal and state laws and the administrative costs involved — can be complicated to set up.

*Here are some trust options to consider.*

- **Trusts and Custodial Accounts** — If you are setting up a trust or custodial accounts for your children, do not tie up so many assets that you are left with insufficient cash or liquidity to support yourself in your retirement years. You may be better off with a revocable trust (you can change the terms and conditions), especially if you're young or your future financial needs and income are uncertain.

*Strategy:* You can always set up separate trusts to cover different purposes (care of aging parents, children's college education, etc.) or to shelter different assets, e.g., placing higher-income-producing assets in the names of your children, particularly those age 18 and over, so the income is *not* taxed at your higher, marginal tax bracket.

Before setting up trusts, get advice from two professionals, principally your lawyer and accountant. The tax rates on trusts are high at low income levels. For 2009, the top tax rate of 35% applies to trust income of \$11,150 or more and the 33% tax rate to income between \$8,201 and \$11,150.

- **Insurance Trust** — You can provide for your family and substantially lower the value of your estate by *not* personally owning life insurance policies which would be included in your estate and taxed at rates up to 45%. An insurance trust can own the policies and be the beneficiary for your spouse and children. The trust can provide annual income to your spouse with cash benefits (the principal) payable to your children upon his or her death. You also can structure the trust to permit your spouse to withdraw from the principal for medical emergencies and the children's educations.

*Here's a simple example:* If there is a \$400,000 life insurance policy in the trust and it earns 6% after taxes, your spouse receives \$24,000 annual income and has the ability to withdraw each year about \$20,000 (5% times \$400,000) for medical emergencies and support. That's a total of \$44,000 annual income. Furthermore, your family saves up to \$180,000 in potential federal estate taxes (45% estate tax rate times \$400,000).

*Don't rush into an insurance trust:* Before setting up an insurance trust, project your spouse's cash needs after your death. Calculate the after-tax liquid (cash) value of your own estate and add to that amount your spouse's liquid assets. If the total is not enough to support your spouse at least through his or her life expectancy, forget about the insurance trust. You don't want to make the avoidance of taxes a high priority when your assets are needed to meet the future cash and lifestyle needs of your spouse. An insurance trust is an option only when you have assets in *excess* of what your spouse can reasonably be expected to need or spend in his or her lifetime.

- **Living Trust** — A living trust, which you set up and use during your lifetime, can be an attractive estate planning vehicle. The principal benefit is that you can control, change, or revoke a living trust at any time. It is popular because the assets in it do not pass through probate, thereby avoiding probate costs and also speeding up distribution to your children and other heirs. However, for tax purposes, living trusts are part of your taxable estate and there are legal and administrative costs involved.

*Be aware:* You must legally transfer title to the trust because the trust must actually own the assets if it is to be effective. Consult with your advisers before undertaking such a move. Also keep in mind that any income generated from a living trust is still taxable income to you.

## **Trust Cautions**

1. *Study all the tax consequences of alternative trust arrangements carefully.* There's not just the current tax on income earned by the trust to be considered. There's also the gift tax involved in transferring assets to a trust for the benefit of someone else and the potential federal estate tax if the trust is in your name or controlled by you at your death. And don't overlook applicable state laws. They can vary significantly in their tax treatment of trusts.

*Alert:* If you moved to another state since the trust agreement was drawn, have the trust documents reviewed by a lawyer in the state where you currently reside.

2. *Determine how much control you want to retain over the trust and its assets.* Don't give up control or ownership rights casually. For example, if your children are the beneficiaries of the trust, they may choose to spend trust assets frivolously on something other than a college education unless you have retained some control over how the trust money will be used.

Establishing an *irrevocable trust* (terms are not subject to change) may have tax advantages for you now but cause you serious financial problems later.

## Tax Alerts and Cautions

- *Arm's-length:* When transacting with your children or other family members, treat them as outsiders (i.e., on an arm's-length basis). If that's impossible for you, at least get supporting documentation. For example, if you own a business and are hiring your children, pay them *comparable* salaries to other employees on your company's payroll who perform similar jobs. Or, if your company rents properties from your children (or even from you), the rental amount should be fair and reasonable, i.e., based on *comparable* rentals per square foot in the area the property is located. (*Note:* Getting comparable data from independent sources in advance is a key to documenting an arm's-length transaction if it is later questioned by the IRS.)

- *Retaining rights:* Be careful of *incidents of ownership* where you retain certain rights (e.g., voting rights) over properties given to family members. Retaining incidents of ownership may lead the IRS to decide you have constructive ownership, making the income from those properties *currently* taxable income to you and including the assets in the value of your taxable estate.

- *Gift limits:* If you *exceed* the annual gift limitation of \$13,000 per recipient for 2009 — even by only one penny — the gift must be reported on a gift tax return even if you are not liable for federal gift taxes. So it's better to plan far enough ahead so that you stay within the annual limitation of \$13,000 per recipient or \$26,000 if your spouse joins in the gift. If you do exceed the annual limit, you can use part of your lifetime gift exemption of \$3.5 million in 2009. However, you will still have to file a gift tax return. *Note:* The total *lifetime* gifts is \$1 million per taxpayer.

Be cautious also of *irrevocable gifts* which you can't take back. In most

states, money put into custodial accounts cannot be reclaimed by the donor.

- *Future interests:* Do not make a gift of a *future interest* of property without expert advice. For example, if you "gift" your child *income-producing property* and retain the right to the income (e.g., giving title to an apartment building but keeping the rental income), that would be a gift of a *future interest* and a tax and valuation problem can arise.

- *Your advisers:* Don't use inexperienced advisers when preparing complex estate, trust, and security sale and transfer documents. The accountant who prepares your tax return or the lawyer who handles your business matters may not be the right choice for those tasks. You want an expert who specializes in estate and succession planning, and is knowledgeable and up-to-date on tax changes, IRS Revenue Rulings, and any proposed legislation which could affect your financial, tax, and estate plan going forward.

## **Family Information Memo**

Preparing a will and estate plan are just the first steps in facilitating the orderly distribution of your estate and assets. Another important step is to prepare a "summary" of your personal finances that lists in a *single* accessible record everything your heirs would need or want to know to administer and finalize your estate.

Remember also that your heirs will need to document the cost basis of assets and investments and place a current value on them. Good recordkeeping will help them do that. Here's what to include in your *Family Information Memo*.

- Your assets:* Home and other real properties, IRA, Keogh, 401(k), and other retirement accounts, automobiles, boats, and luxury items (jewelry, furs, art, antiques).

- Investments:* Type of investment (real estate, savings, bonds, stocks), the purchase price and date.

- Financial records:* Deeds, personal financial statement, past tax returns, credit card numbers, Social Security number, marriage and death certificates, etc.

*Life insurance:* Name of insurer, policy number, face amount of insurance, type of insurance (e.g., whole life, term, universal), dividend accumulations, borrowings, beneficiaries, and location of policies.

*Outstanding debt:* A listing of loans in which you are the lender and those in which you are the borrower. Provide complete details: name of lender, amount, payment terms, due date, collateral, guarantees, etc.

*Legal papers:* Wills, Trusts, Health Care Proxy, Power of Attorney, Titles to Ownership, and Loan and Mortgage Agreements.

*Business-related documents:* Ownership papers, buy-sell or succession agreements, valuation report on the business, personal guarantees of business loans, employment contract, deferred compensation agreement, and all business insurance on your life (group, split-dollar, key-executive, etc.).

*Tax-related papers:* Tax returns and backup, W-2s and 1099s, investment statements, cancelled checks, bank statements, purchase documentation for stocks, bonds, collectibles, etc., charitable receipts and appraisal reports. For special tax deductions, e.g., for a second/vacation home or business expenses, include all cancelled checks, receipts, and other required documentation, such as depreciation writeoffs on investment properties.

*Gifts:* Legal documents, gift letters, correspondence, and all tax returns which refer to gifts made to family members and others. *Reason:* The IRS may look at all gifts in the context of your lifetime exemption when reviewing your estate tax return.

*Advisers:* Names, addresses, and telephone numbers of your lawyer, insurance agent, broker, accountant, and banker.

*Instructions in case of death:* Include funeral arrangements, burial plot, persons to be notified, location of safe deposit box and its key.

*Joint ownership:* When preparing the information above, make a notation of which assets are jointly owned with your spouse. This notation is needed to place a value on your own estate since only 50% of jointly held property is included in the value of your estate.

*The steps in good recordkeeping:* (a) Determine the information that has to be collected, both personal and business, (b) compile the data, (c) set up files for each area of finances (e.g., home, investments, business, estate papers), and (d) prepare your *Family Information Memo*, as outlined above, which lists all individual files, the documents and papers included in each file, and where the files are located (i.e., at home, in your safe deposit box, with your accountant or lawyer, or at your business).

Remember, the goal of good recordkeeping is to assure that your family receives everything to which they're entitled and to protect your deductions and assets from IRS attack, both today and after your death. Without proper documentation, the IRS can disallow a deduction and challenge the cost basis of any assets which can't be confirmed by a cancelled check or other means.

## **Your Executor/Executrix**

A person with a simple estate can afford to name an executor for purely personal reasons, e.g., a spouse or a friend. But, in today's complex financial environment, it's rare to have a simple estate and so the choice of an executor with good judgment and business acumen who understands the details of your estate is critical.

The complexities of the job increase when a business ownership represents a sizable portion of the estate. In that case, your executor/executrix may have to contend with disputes among your heirs or even minority stockholders. There is always the chance that someone will challenge your will, including any succession or management agreements, you signed during your lifetime. That's why you should appoint an executor/executrix who is financially astute and capable of understanding the details of your estate and your assets. *Here are some guidelines to consider.*

- 1.** If your executor doesn't have investment or real estate management expertise, you may wish to specify or recommend certain individuals or firms with whom he or she should consult on decisions in those areas.

- 2.** Don't automatically name your spouse as sole executor. That may be appropriate if your estate will be simple. But if your estate will include such items as a business, or investment income that must be re-invested periodically, you may

want to name co-executors — a spouse *and* a financial institution or a trusted friend and a financial institution. If a business is part of the estate, selecting your accountant, lawyer, or a company executive as executor or co-executor is often a good idea because he or she is already familiar with your business, knows your intentions, and can better assist in directing the operations of the business. Your executor and advisers also should be aware of the tax options available to deceased business owners. Especially important are Internal Revenue Code Sections 303, 2032A, and 6166.

**3.** Your executor should not have a conflict of interest. *Example:* You don't want a business associate who owns part of the business to be the executor. His or her personal goals regarding the business may be very different from your goals or your family's.

**4.** Provide for an alternate executor just in case your primary executor is unable to perform or becomes sick or disabled before the estate is settled.

**5.** Consult with your lawyer as to whether you can make your recommendations *binding* on your executor; state law can vary on this issue. Also discuss the *blank-check* or *disclaimer* option whereby your spouse has the right to change the *amount* and *form* in which the assets are received.

**6.** Discuss the job with your executor before naming him or her to determine willingness to serve; and be certain he or she understands the commitment being made.

**7.** Costs also should be considered. If an individual outside your family acts as an executor, he or she may want to be compensated for the services. You can negotiate the fee or follow statutory precedents. If a financial institution is selected, fees will vary depending on the size of your estate and state law.

The burden of an executor is great. Estates can take months or years to settle, much longer if disputes arise or if there is a problem valuing the ownership in a business. In addition, the personal and financial liability of an executor is significant since the responsibilities are fiduciary. So select an individual or firm who is up to the task.

## Estate Taxes and Cautions

When planning for estate taxes, remember that every individual is entitled to exclude from federal estate taxation the first \$3.5 million (2009) of personal assets. In addition, there is the unlimited marital deduction, which should be discussed with your lawyer and insurance agent when reviewing your need for life insurance to pay estate taxes. *Reference:* Please see *Exhibit 2* (page 28) for a review of the estate tax law changes which took effect in 2001 and to be repealed in 2011. These changes **must be considered** in your planning.

### *Other advisories:*

- Talk to your lawyer about providing for a *bypass provision* in your will. This provision in effect allows for the \$3.5 million federal estate exemption per taxpayer and can save substantial estate taxes.

- If you're planning to transfer the ownership of certain life insurance policies, be aware that the transfer *must* occur more than three years prior to death. If it doesn't, the insurance proceeds, even though they are payable to another individual or trust, will be included in the value of your estate for both federal and state taxation.

- Many married couples hold much of their property *jointly*, like the family home. Sometimes joint ownership is prudent; other times it can lead to tax problems. Check with your advisers on which assets should be held *jointly* and which might be better held in *individual* names.

*Reason:* For estate planning purposes, you want to make maximum use of the unlimited marital deduction, as well as equalize the value of each spouse's estate, to take full advantage of the \$3.5 million exemption per taxpayer.

## Signals to Write a New Will

To reinforce the importance of updating your will, here is a summary of the major events that will require a call to your lawyer.

- *You move to a new state:* The will drawn in the state you left may not be completely valid in the state in which you currently reside. Be sure your will conforms to the laws in your *new* state of residence. *Important:* A move from a community-property state to a common-law state — or vice versa — can definitely signal a will revision.

- *You purchase property in another state:* Complications can arise if you have property in two different states because two sets of laws and taxation may apply. Furthermore, there are additional legal and probate costs for properties located in states other than the state in which your will is being probated, i.e., the state in which you are domiciled at the time of your death. Be sure your lawyer is advised of new property purchases.

- *Your family changes:* Birth, death, marriage, divorce, adoption, separation — any of these may affect certain provisions of your will and life insurance needs, e.g., your children are no longer dependent on you or a beneficiary you designated has died.

- *Your asset structure is complicated:* If you own homes in more than one state, make sure it's clear which home is your principal residence, e.g., the same as on your tax returns. Also, any changes in your asset structure, such as inheriting property from a relative or the sale of a business, may require an amendment to or a revision of your will.

- *Tax law changes:* New tax legislation can affect your estate planning, life insurance needs, and the value of a business. For example, the unlimited marital deduction and the lifetime exemption of \$3.5 million per taxpayer reduce your potential estate tax bill and possibly the need for select life insurance policies. However, be sure to consider the repeal of the 2001 Tax Act, which is explained in *Exhibit 2*, page 28.

## **Your Life Insurance**

Your life insurance should be reviewed at the same time as your will and other estate components. An overlooked policy can undermine your plans for an equitable distribution of your assets or it can subject your heirs to huge,

unexpected taxes.

Start by having your insurance agent prepare a listing (by policy) of the beneficiaries and the basic provisions in each policy: waiver of premium, double indemnity, dividend options, right to convert to other forms of insurance (e.g., from term to a permanent life policy), and for how long the policies are in effect (e.g., to age 65 or death). Second, check out the ownership on all policies. If you are the owner of the policy, the insurance proceeds will be included in the value of your estate. *Caution:* Don't transfer the ownership of any insurance policy without good advice; you don't want a taxable transaction where the insurance proceeds are taxable income to you or your beneficiary.

Third, make sure your insurance is *locked in*; it can't be cancelled and it is renewable if a term policy.

Fourth, review the following other common life insurance mistakes and get advice on how to avoid them.

### ***Mistake #1: Not Being Specific***

Spell out the full name and relationship of all beneficiaries. For example, an ex-wife may make a claim on a policy in which the beneficiary is identified only as "Mrs. John Jones," and naming "my children" may cause a great deal of confusion if there are stepchildren, adopted children, or children by two marriages. There also have been instances where a younger child, never added to the beneficiary list, was excluded from all insurance benefits.

### ***Mistake #2: Not Naming Sufficient Contingent Beneficiaries***

Naming your spouse as *sole beneficiary* is never a good idea, even if both of you are in good health. You should exercise your right to name contingent beneficiaries to assure that if you and the primary beneficiary die in a common accident, the insurance proceeds will go to the second person you would have selected.

*What to do:* Discuss with your insurance agent the need for and use of a common disaster clause and the designation of primary, contingent, and tertiary beneficiaries.

### ***Mistake #3: Not Reflecting Status Changes***

You may be making this mistake if you're still carrying the same amount and

type of life insurance coverage you took out 20 years ago even though your children are now grown, your assets have increased, and your spouse has been provided for by your will or trust.

*When should you consider changing beneficiaries?* Any time you make a change in any of your other estate components (e.g., your trust, wills) and any time there is a change in your family caused by birth, death, marriage, or divorce.

Reviewing your entire estate package, including your will and insurance policies, *at the same time* also ensures that all your intended heirs will be treated fairly. *Example:* If you have given one child money to buy a house, you may decide to name another child as the beneficiary of a life insurance policy as a way of equalizing your gifts to them.

#### ***Mistake #4: Not Retaining Flexibility***

Be cautious about naming any beneficiary *irrevocably*.

*Reason:* You will have to obtain that individual's permission to change beneficiaries in the future or to borrow against the equity (cash value) in the insurance policy. You also may want to alter your policy in the future to protect your natural children if you are married a second time to a spouse with children of his or her own.

*Retain further flexibility by doing the following:*

- To meet different objectives or provide for different groups of heirs, use different life insurance policies. One policy may cover a specific child's education, another may name grandchildren as beneficiaries.
- To prevent misuse of the insurance money, particularly when young adults are the beneficiaries, consider including provisions for paying out insurance proceeds gradually or for providing for a waiting period before the entire amount is paid out.

#### ***Mistake #5: Failing to Coordinate Life Insurance with Your Will***

A carefully worked out estate plan can go awry if life insurance is not considered when the plan is prepared. For example, a forgotten insurance policy, naming one child as beneficiary or contingent beneficiary, can upset an otherwise equal distribution among your children. The same insurance policy might result in an outright gift when your intentions, and the provisions of your will, are to

provide a trust arrangement.

### ***Mistake #6: Switching or Cancelling Policies***

Don't cash in, switch, or cancel any life insurance policy without first considering these cautions.

- The annual increase in the cash surrender value of an *existing* life insurance policy may be near or greater than its annual premium. In effect, you are building equity and borrowing power every year you pay the premium on this existing policy.
- The annual dividends paid on the *existing* policy also could be near or equal to its annual premium cost. This means your *net* premium cost (after dividends) for the policy is nominal or very low. (*Please note:* This is particularly true on policies issued many years ago.)
- There is a two-year contestability provision on new life insurance policies. This provision give the insurance company the right to contest an insurance claim if there were any material misrepresentations on the application, especially the non-disclosure of pre-existing medical problems.

### ***Mistake #7: Not Considering Other Types of Policies***

- Look into split-dollar insurance. It's an excellent fringe benefit for business owners and executives; it also builds a cash value and the dividends can be used to reduce the annual premium cost.
- If you have a buy-sell agreement with other shareholders, consider funding it with life insurance. To lower the total premium costs for insurance on each owner's life, consider purchasing *first-to-die insurance*.
- Consider *second-to-die* life insurance on both your and your spouse's lives. This insurance can reduce your annual premium for life insurance that is needed to protect your children and pay potential federal and state estate taxes.

### ***Mistake #8: Not Using Your Business To Help Pay Premiums***

- Talk to your insurance agent about IRC Section 162(a), bonus plans. Your company could get a tax deduction for providing you with life

insurance protection.

- Consider having your company's retirement plan buy life insurance policies on your life rather than you buying them and paying the premiums with your *personal* after-tax dollars.

### ***Summary: What to Do***

Call a meeting of your important advisers; include your accountant, lawyer, and insurance agent. Use the occasion to review your will, your insurance, your business documents and plans, and your estate in view of tax law changes or changes in your personal *and* business financial position. Start by using the questions on page 25. □

*References —*

*Exhibit 1: Questions for Your Advisers, see page 25*

*Exhibit 2: Estate Planning and Repeal of Estate Taxes, page 28*

## Questions for Your Advisers

A review of your estate and will with your advisers can be an intimidating task. There are many issues to cover and the impact of your decisions on your dependents and heirs will be substantial.

Here is a suggested outline of the manner in which you can approach this complex subject and the types of questions you should formulate in advance to guide the discussion. They will vary, of course, with your personal and business situation, but these questions will at least provide you with a general idea of how to proceed. *Note:* The dollar estate limits below apply to 2008. There also are ideas and questions if you own part or all of a business

Here is my personal financial statement with notations on which assets are owned jointly with my spouse. Based on this data, I have two questions:

- Assuming I die first, how much in federal and state estate taxes will have to be paid?
- What will be the federal and state estate tax bill when my spouse dies if she or he survives me and owns all of the assets, including the business, at her or his death?

Now that we have determined the potential federal and state estate tax liabilities, what actions do you recommend I take to reduce the tax liabilities on both my and my spouse's estate?

I and my spouse want to take full advantage of the \$2 million lifetime estate tax exemption (\$4 million total). What assets should be transferred to accomplish this objective? Will setting up a trust or family limited partnership help reduce my family's estate taxes?

Should I provide for the *blank check option*, which gives my spouse the

right to change the form and dollar amount of the assets she/he receives?

I have a lot of life insurance I own personally, so it will be included in my estate. To lower the value of my estate, should some of these policies be purchased/owned by my spouse or transferred to an insurance trust?

One of my children is still a minor, age 15, and I want to provide about \$75,000 for her future college costs. Should I make her a beneficiary of one of my life insurance policies? What about making her the owner of the policy to get it out of my estate?

Since my last will was prepared, I have purchased a condo in Florida worth \$175,000, my oldest daughter got married, and a grandchild was born, for whom I would like to provide some education money. How should I set aside the education money and what changes and additions should be made to my will?

Should I give my business ownership to my children now or do it through my will? If I use my will, they avoid capital gain taxes since *their* cost basis is the stock's fair market value at my death, not my low cost basis from when I started the business. *Note:* Starting in 2010, the benefit of this tax-saving strategy is partially eliminated. See *Exhibit 2*, page 28.

There are two executives in my company who wish to become stockholders. They have the personal resources to pay the premiums on life insurance policies they can use to purchase my stock at my death. Should I enter into a buy-sell agreement with them? As it stands now, my wife will receive all of my stock, which is currently valued at \$800,000.

Another executive I know stipulated in his will that his four children will receive their inheritance over a 12-year period, 25% every three years. Should I do the same for my two children?

Can my life insurance policies, whose premiums I pay with my personal after-tax dollars, be transferred to my pension plan?

What about these ideas I've read about: Use of a living will, QTIP,

health care proxy, personal residence grantor trust, and a family limited partnership?

*And for my business ownership:* Let's discuss Sections 303, 2032A, and 6166 of the Internal Revenue Code, a buy-sell agreement, and my wishes on interim management of the company.

## Estate Planning and Repeal of Estate Taxes

Don't make the mistake of assuming that the repeal of estate taxes means you don't have to do any estate planning. *That's not the case for several reasons.*

First, all of the changes below *apply only* through 2010; the 2001 tax law itself **automatically expires** in 2011. Second, the law contains several negative provisions that in part offset the lower/eliminated taxes and carry their own new tax burdens.

- *Estate Exemption:* The estate tax exemption per taxpayer is \$3.5 million in 2009. In 2010, the estate tax is **fully repealed** so no federal estate taxes will be payable in that year. However, in 2011, the estate tax laws are then **reinstated** effective January 1, 2011 at which time the lifetime exemption **goes back** to \$1 million and the tax rate to 55%.

- *Estate Tax Rates:* The top federal estate tax continues at 45% from 55% (before the new legislation) and stays at 45% through 2009.

- *Gift Taxes:* Starting in 2010, the top gift tax rate will be the taxpayer's top individual income tax rate. *Note:* The lifetime gift tax exemption **remains** constant at \$1 million even though the estate tax exemption is \$3.5 million in 2009.

- *State Death Tax Credit:* Under prior law, the state death tax could be used as a credit against a taxpayer's federal estate tax bill. Starting in 2004, the tax credit was eliminated and *replaced* with a tax deduction, which means more federal estate taxes through 2010.

*Note on state laws:* Most states currently have an estate tax that's similar to the federal estate tax. While some states may decide to repeal or amend their estate tax laws, many won't. That means you will have to continue to take state taxes into account in drafting your will or planning for estate taxes.

- *Stepped-Up Basis*: Starting in 2010, the *stepped-up basis rule*, whereby an heir could receive assets at their current fair market value, is eliminated. Instead, the decedent's cost basis will be the established fair market value for the heir, which means more taxation when the assets are eventually sold. *Exceptions*: \$1.3 million for assets left to beneficiaries and \$3 million for surviving spouses.

*What to do*: Under the old tax law, you could design an estate plan that provided maximum protection for your heirs no matter when you died. But, with the *annual* adjustments in estate tax rates and exemptions, you have to build those adjustments into your estate plan also. Then, in 2011, when the 2001 tax law expires, you will have to do yet another estate plan to comply with and reflect whatever new law replaces it. □

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The company was formed in 1974 by Thomas J. Martin. Martin has written more than 900 articles and advisories and presented *hundreds* of workshops and seminars to *thousands* of business owners and executives on many of the subjects covered in *The Business Library*. He is an Investment Banker and an expert witness in Valuation and Succession Court Cases. He has helped *hundreds* of business owners and executives raise capital, refinance debt, prepare for succession, and value and sell their businesses.

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