

***EVERYTHING YOU OWN
&
EVERYONE YOU CARE ABOUT***

An Estate Planning Primer

For The Clients Of

**PPA PANAGIOTU
PENSION
ADVISORS**

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Everything You Own & Everyone You Care About

Common Estate Planning Questions and Answers

WHAT IS ESTATE PLANNING? Estate Planning is preparing for the orderly transfer of *everything you have, to everyone you care about*. In short, it is legally arranging to **give what you have, to those you want to receive it, when and how you want them to receive it, with a minimum of taxes, court costs, legal fees and hassle for your family.**

WHO SHOULD PLAN? **Everyone**, single or married, who has accumulated any assets and wishes to determine how those assets will be managed in the event of incapacity, or distributed at the time of death. **No estate is too small for planning. It is especially important if you wish to control how your assets will be managed or transferred if you become disabled, or at the time when you die; if you have minor or special needs children or grandchildren; if you intend to provide for particular charities; or if you want to save estate taxes and probate costs.**

WHAT IF MY ESTATE IS NOT VERY LARGE? You should still plan. **Otherwise, your estate is guaranteed to go through the probate court and State law will determine who will receive your assets.**

HOW DO I KNOW IF I NEED ESTATE TAX PLANNING? The Federal tax laws allow each of us a tax credit to protect a portion of our estate against the inheritance tax. **In 2011 and 2012, any individual can protect the first \$5 million of his/her estate against Federal estate tax, and the first \$2 million against estate tax to the State of Washington. If properly planned, most married couples can easily protect their estate against paying any estate tax.** For larger estates there are additional legal techniques for management and transfer of assets to heirs in ways that minimize the taxes.

NOTE: Under the current law, the Federal Exemption Amount is scheduled to return to \$1 million per person, for the year 2013 and thereafter.

NOTE: The current Federal Estate Tax rate is approximately 35% of the value of the taxable estate.

NOTE: The Washington State Estate Tax rate is approximately 17% of the value of the taxable estate.

HOW MUCH WILL PLANNING MY ESTATE COST? Planning discussions and preparation of basic Estate Planning trust documents often take several weeks to complete. Legal fees for this work generally range between \$500 and \$5,000 depending on the complexity of your wishes, and the scope of work. Estate Planning documents have significant legal and tax consequences. You should consult a qualified, experienced estate planning attorney who can help you customize your estate plan to meet your personal goals and objectives.

WHEN SHOULD I PLAN? Now! Estate planning is done in order to prepare for the event of an injury or illness resulting in incapacity or death. None of us likes to think about our own mortality, or even the possibility of becoming incapacitated. That is why **so many families are caught off guard and unprepared when incapacity or death strikes. You can only plan your estate before these events occur. Afterward, it is too late.**

Estate planning is one of the most thoughtful and considerate gifts you can give to your family.

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Definitions and Commonly Used Terms

ESTATE - Everything you own. This includes personal property, real estate, retirement plans, life insurance death benefits, and business interests. The value of your estate is equal to the fair market value of *all* of your assets.

EXEMPTION AMOUNT – Current Estate Tax law allows each person to transfer a certain amount that is exempt from estate tax consequences. The *2011 and 2012* Federal Exemption Amount is \$5 million. Unless Congress changes the law, the Federal Exemption Amount is scheduled to return to \$1 million, per person, for 2013 and thereafter. Washington State currently allows each person to exempt up to \$2 million.

UNLIMITED MARITAL DEDUCTION - Current tax law allows the tax-free transfer of an estate from a deceased spouse to a surviving spouse. Estate taxes are not assessed or due until the second spouse dies.

PROBATE - The public, court-imposed legal process of protecting creditors, changing title, and managing assets for people who have died or become incapable of managing for themselves. Since deceased or incapacitated persons are legally incapable of owning or transferring property, the probate court protects creditors and arranges for transferring a decedent's or ward's property. In Washington State, the probate process has been simplified, but it is still a matter of public record, and probate costs and fees average between 1% and 4% of the total value of the estate. Owning property in another state will require multiple probates.

WILL - A legal document that advises the probate court about a decedent's wishes for distribution of their assets. **A Will is only effective after the Willmaker's death, and a Will must be probated.**

WILL SUBSTITUTES - Certain forms of ownership transfer property automatically on death. The most common Will substitutes are Beneficiary Designations, Community Property Agreements, and joint tenancy. Will substitutes can cause unforeseen results and unanticipated taxes, and generally only postpone probate.

TRUST - A legal document that provides instructions to a personal trustee regarding how to manage and distribute the assets held by the trust. Trusts can be written for many purposes; for example, to provide for minor or spendthrift children; to fund a charitable gift; to protect children from prior marriages; to use life insurance to replace wealth that will be lost to estate taxes; to comply with tax law requirements; to protect the use of the estate for spouses who are not U.S. citizens, or for any other legal purpose that satisfies what the creator of the trust wants to accomplish. A **Living Trust** is established during lifetime, and is usually revocable and amendable. Assets held in a Living Trust avoid probate, and can be managed according to your instructions in the event of incapacity or death. A **Testamentary Trust** can be established as a part of a Will, but like a Will, is only effective on death, and must also be probated.

When you create a trust, you (*Grantor*) transfer your property into the name of the trust, to be managed by you or someone else that you choose (*Trustee*) for the benefit of yourself or someone else (*Beneficiary*). In a Living Trust you are generally the *Grantor*, *Trustee*, and *Beneficiary* to begin with so that you retain total management and control over your assets. However, at the time of your death, if the trust is then the owner of everything in the estate, there is nothing to probate and the probate process is avoided. Your Successor Trustee simply follows your instructions for further managing and distributing your estate to your Beneficiary(ies). A Revocable Living Trust does not require any special or additional tax filings, and can generally be revoked or amended at any time.

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Important Estate Planning Documents

BENEFICIARY DESIGNATIONS - Beneficiary designations are one of the most important and flexible personal estate planning tools. They are documents in which the account owner “designates” one or more beneficiaries to inherit the assets held in 401(k) plans, 403(b) plans, IRAs, life insurance policies and annuities. Assets that have beneficiary designations generally avoid the probate process at death, and pass directly to the designated beneficiary. **A Will or Living Trust does not automatically control the disposition of retirement account and/or life insurance proceeds.** An uninformed or carelessly prepared beneficiary designation can cause a loved one to be disinherited, children to receive benefits before they might be capable of managing the funds, creditors of the beneficiary to have a claim against the proceeds, a disabled child to lose government benefits, and heirs to lose tax planning opportunities and/or unnecessarily pay taxes.

DURABLE POWERS OF ATTORNEY - A Durable Power of Attorney authorizes someone to act on your behalf *while you are alive*. The person appointed to act for you is called your attorney-in-fact or agent. A Special Power of Attorney authorizes the agent to act in a limited capacity, or to act on your behalf for only certain specified purposes. A General Power of Attorney authorizes the agent to do virtually anything you could do. A General Power of Attorney is a very powerful document. A Power of Attorney can be written to be effective either immediately upon signing it, or only effective if you become legally incapable of acting on your own behalf.

HEALTH CARE DIRECTIVE - A Health Care Directive, sometimes called a Living Will, is intended to be a written expression that your personal preference is that no one use extraordinary measures to keep you alive if you are dying. There is nothing about the Health Care Directive that is mandatory, or that requires anyone to do or not do anything. The person(s) with your Health Care Power of Attorney, or the closest family member, will make the ultimate decision about life support measures.

COMMUNITY PROPERTY AGREEMENT - Washington is a Community Property State. That means that there is a legal presumption that whatever a husband and wife own, they own as community property, rather than as separate property. Married couples can confirm that they own everything as community property by signing a written Community Property Agreement. The advantage of the written Community Property Agreement is that it allows couples to avoid probate when the first spouse dies. NOTE, however, using a Community Property Agreement to avoid probate is not appropriate if the married couple has a taxable estate. The result may be that substantially more estate tax than might have otherwise been due is paid when the second spouse dies. A Community Property Agreement might also be inappropriate when there are children from prior marriages.

WILL or REVOCABLE LIVING TRUST - All properly planned estates should include either a Will or a Revocable Living Trust to describe who will benefit from the estate, and how the heirs are to receive their inheritance. There is no additional tax advantage to using either a Will or a Living Trust. Credit Shelter Trust tax planning can be written into both Wills and Living Trusts. The only significant difference between the two is that a Will requires probate, and a Living Trust that holds all of the decedent’s property avoids probate. A properly written Living Trust also includes instructions about managing your estate for your benefit if you become disabled.

While a Will should work fine in Washington, if one of your most important goals in estate planning is to make the process of transferring your estate to your heirs a private matter, and as easy and hassle-free as possible, and/or if you own property in another state, the Living Trust is generally the better choice.

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Basic Estate Tax Rules

There is one set of tax laws for the INFORMED, and a different set of tax laws for the UNINFORMED.

First, it is common knowledge that currently each of us can generally protect up to the Exemption Amount before any estate taxes are due. Many people *incorrectly* believe therefore, that most married couples need not consider estate planning for tax reasons until the value of their joint estate exceeds two times the Exemption Amount.

The INFORMED client, however, knows that the only way to protect the Exemption Amount for both spouses, particularly for Washington State Estate Tax purposes, is to have the appropriate tax planning provisions written into the Will or Living Trust. This is commonly referred to as Credit Shelter Trust, A-B Trust, Bypass Trust, Exemption Trust or Family Trust planning, and it must be written **BEFORE** the first spouse dies. Otherwise, when that death occurs, the ability of that first spouse to protect the Exemption Amount from taxes can also pass away.

Second, there is a common misunderstanding that Estate Taxes are due at the time of the first spouse's death. In 1981 Congress passed a tax law referred to as the Unlimited Marital Deduction. That law says that no Federal Estate Tax will be due at the first spouse's death on any amount that passes to (or for the benefit of) the surviving spouse.

The *good news* is that the surviving spouse no longer has to worry about depleting the remaining estate by paying taxes. The *bad news* is that the surviving spouse's estate is now that much larger; and for couples who did not prepare tax planning provisions in their Wills or Living Trust, the ultimate tax bill is likely to be higher than had the tax been paid at the time of each death.

Even if your combined estate may not exceed the Exemption Amount at the time of the first spouse's death, if it grows because of appreciation or inflation, it will be taxed at the rate shown below when the second spouse dies. **Current Federal Estate Tax rate is approximately 35%** of the value of your taxable estate. The rates for the State of Washington range between 10% and 19%.

Third, the Capital Gains Tax applies to all gains from appreciation in value to virtually all of our assets. The UNINFORMED sometimes try to transfer their property prior to death, generally to avoid the probate. The INFORMED know that at the moment of death, the current tax laws give us a "stepped-up basis," which eliminates the capital gain on most of our assets, and allows the survivors to transfer the decedent's property without subjecting it to an additional Capital Gains Tax. Stepped-up basis does not apply to most retirement account assets.

In most states, this stepped-up basis only applies to property owned by the decedent. In Washington, because we have the Community Property laws, there is a full stepped-up basis on all community property.

Fourth, most people know that they can currently give up to \$13,000 per person, per year, to anyone they wish to give to, without paying any gift tax. This law is called the Annual Exclusion Amount.

A Gift-giving strategy can be a very useful and effective planning tool when it is appropriately structured. The INFORMED are careful with their gifting because they know that the Annual Exclusion Amount is cumulative, and includes all gifts (Birthday, Christmas, Anniversary, etc.) made during the year. The UNINFORMED may inadvertently subject their gifts to the Gift Tax.

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Preparing To Meet With Your Estate Planning Attorney

When you are preparing for your initial meeting with your estate planning attorney, you should gather and review all of the following:

1. A list of all real estate and all other assets, with an estimate of the current fair market value. A Confidential Estate Planning Client Information Worksheet is available by calling Gary Connett.
2. Copies of any existing estate planning documents, i.e. Wills, Community Property Agreements, Durable Powers of Attorney, Beneficiary Designation Forms and any existing trust documents.
3. A list of all insurance policies showing face amounts, cash values, named insured, and the names of all beneficiaries and contingent beneficiaries.
4. Copies of any business documents such as Partnership Agreements or Stock Purchase Agreements.
5. Account ownership and beneficiary designation information on any retirement plans and insurance policies.

You might also want to think about the following important issues:

- ▶ What are your goals, aspirations, needs and desires in doing this planning? What is the “legacy” you want to leave? We will want to design your plan so that it specifically satisfies those purposes.
- ▶ Who will you want as your personal representatives in the case of a Will, or successor trustee in the case of trust planning? And, who do you want to name in the event that those persons are unavailable? You can select anyone you choose, including corporate or bank trustees, with the exception that the person you select cannot have ever been convicted of certain crimes.
- ▶ Who do wish to appoint as a guardian if you have minor children?
- ▶ Do any of your children, grandchildren or other family members have special educational, medical or physical needs?
- ▶ Are there any other special planning needs or creditor protection issues to address for emotionally or financially unstable children or heirs, or for children from previous marriages?
- ▶ What charities, organizations, or persons other than immediate family do you wish to provide for?

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Quality Estate Planning requires a customized approach designed to meet the individual goals and needs of each client. Estate Planning documents have significant legal and tax consequences and should be prepared by a qualified attorney.