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The Three Principles of Estate Planning

By Lindsey Markus

No client or attorney can avoid death and taxes, but estate planning does not need to be overwhelming. Estate planning can be explained through three guiding principles: minimize estate and income tax consequences; avoid probate; and provide asset protection for beneficiaries.

Estate and Income Tax Consequences

Adjusted annually for inflation, the 2014 federal estate tax exemption is $5.34 million per person (and will be increased to $5.43 million in 2015). However, the Illinois estate tax exemption is $4 million per person (no inflation adjustments). The tax rates for Illinois residents are 28.5 percent from $4 million to $5.34 million and 50 percent on every dollar over $5.34 million.

With proper planning, these taxes can be minimized or avoided. Ideally, a married couple with a properly structured estate plan should be able to pass $8 million and $10.68 million at the federal and state levels, respectively, with no tax owed until the surviving spouse's death. However, due to the Illinois estate tax exemption, in 2014, Illinois residents with outdated documents may be subject to a tax of $382,857 on the first spouse's death. This analysis is based on Illinois Attorney General Estate Tax Calculator 2013 – 2014. As the federal exemption is adjusted annually for inflation and the state exemption stays at $4 million, the potential tax will continue to increase. With exemptions so high, and income tax rates increasing to 23.8 percent, clients need to update documents to minimize income tax consequences for future generations. Revocable living trusts provide the flexibility to maximize estate and income tax planning.

Avoid Probate

Unlike the high estate tax exemptions, the threshold to avoid probate is much lower. The families of decedents with assets valued at $100,000 or more titled in their individual names are required to open a probate estate. Additionally, guardian estates need to be opened for any minor child, further draining inheritances. Many clients try to avoid probate with strategic titling of assets which pass to specific beneficiaries by operation of law or transfer on death designations. These forms of ownership are problematic if the parties die simultaneously; fail to maximize the use of estate tax exemptions; provide no asset protection for beneficiaries; and may mandate guardian of the estates for minor children.

In contrast, if virtually all assets are titled in a client's living trust prior to death and beneficiary designations list the living trust, the probate process and guardian estates can be avoided.

Asset Protection

While many are not faced with creditor concerns, in today's litigation-crazed society, I advise clients to live by my mother's adage, "hope for the best and prepare for the worst."

Trusts provide asset protection from creditors, including future ex-spouses; protect minor children from themselves; ensure inherited retirement plans are asset protected; and maximize wealth transfer.

When assets are distributed outright and free of trust (or when a beneficiary has rights of withdrawal upon reaching certain ages) the assets are reachable by creditors and included in the beneficiary's taxable gross estates. In contrast, if assets remain in trust, even if a beneficiary becomes his or her own trustee upon reaching a certain age, asset protection can be maximized.

For these reasons, clients are encouraged to have the following four documents as the foundation of their estate plan.

Pour Over Will – When a client has a living trust, ironically the will plays a minor role. A pour over will works in conjunction with a living trust. Any assets titled in the decedent's individual name will pour over into the decedent's trust at death. This provision does not ensure the assets avoid probate. To ensure assets avoid probate, clients must retitle assets into the name of their trusts prior to death.

Revocable Living Trust – A living trust provides no asset protection during the grantor's lifetime, but upon death the living trust becomes irrevocable and assets can be passed in trust to beneficiaries. It can provide for the creation of trusts which can be used to promote values to heirs (encourage education and philanthropy) and protect the inheritance from the reach of creditors, government (in the case of a special needs beneficiary), judgments or divorces. In the event of the grantor's incapacity, guardianship or conservatorship proceedings are also avoided as the successor trustee comes into power in the event of disability or death.

Power of Attorney (POA) for Property & Health Care

Everyone over the age of 18 is encouraged to have POAs for property and health care. The latest statutory POA for property became effective in July 2011 and the latest statutory POA for health care is effective in January 2015. Clients with outdated POA for health care should make sure their existing grants the agent access to medical records to make informed medical decisions in accordance with the Health Information Portability and Accountability Act.

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