AOF Financial Planning

Lesson 19

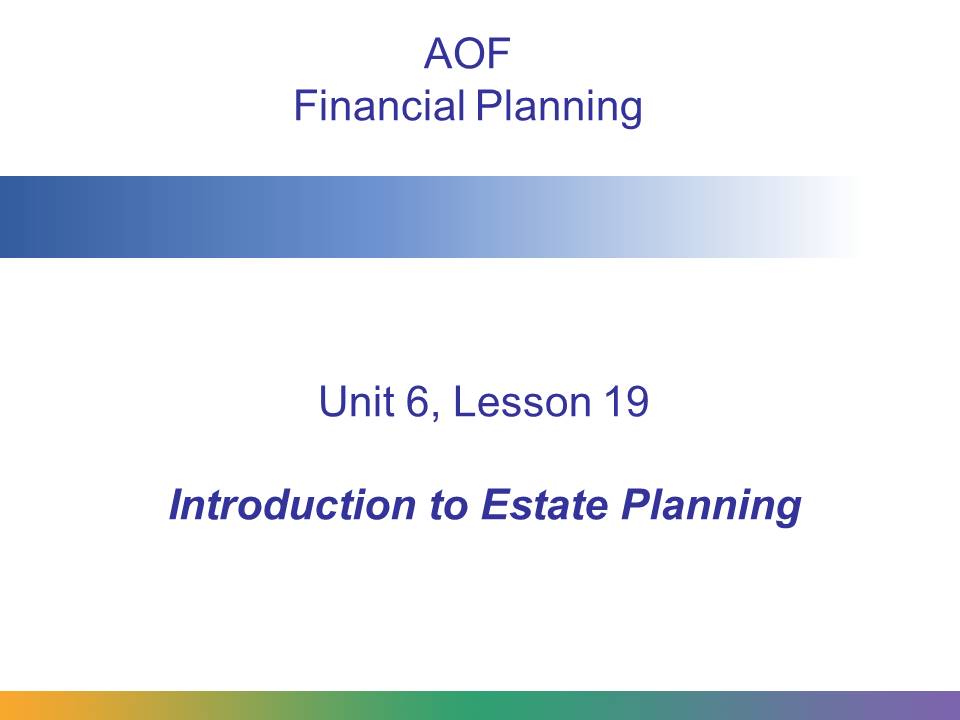
Estate Planning

Student Resources

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Student Resource 19.1

Reading: Introduction to Estate Planning



One important role of a financial planner is to help people prepare financially for when they die.

This type of planning and preparation is called estate planning. An *estate* is the assets that the deceased person passes on (or bequeaths) to others.

This presentation covers the basic concepts in estate planning for financial planners, including:

* Wills
* Living wills
* Power of attorney
* Inheritance taxes
* Trusts

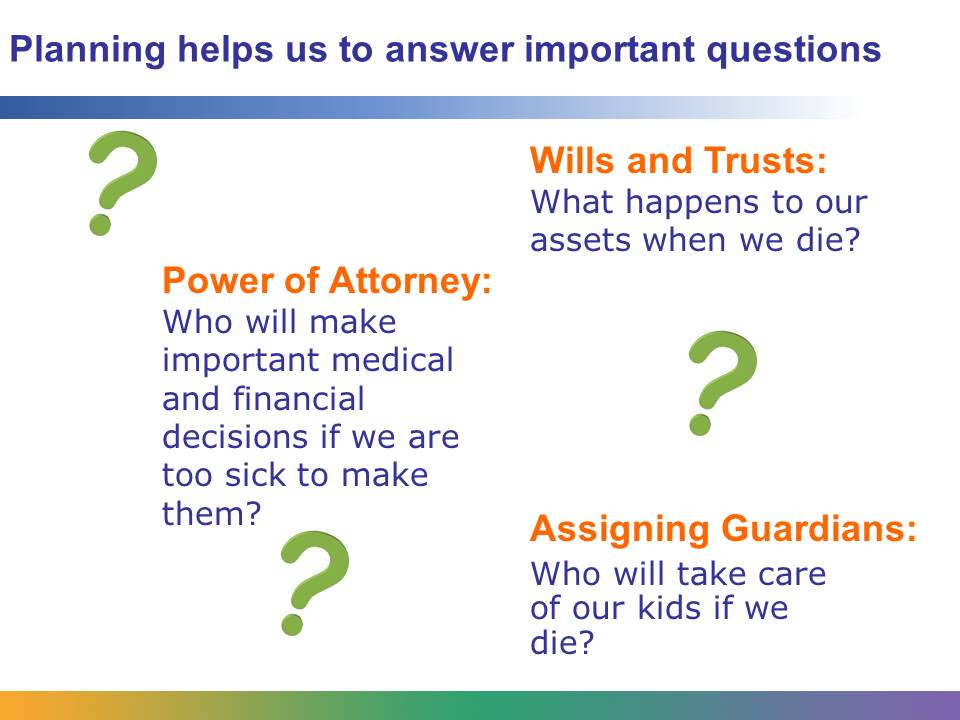


Few people know when they are going to die. Most of us will live well into and past our 70s, but some will die earlier. Because we don’t know such things, it is important even for younger adults to conduct estate planning.

Estate planning helps us to answer some important questions:

* What happens to our stuff when we die?
* If we are too sick to make medical and financial decisions, who will make them for us?
* Who will take care of our kids or our pets if we die?

As a financial planner, you can help people to make decisions about these important things.



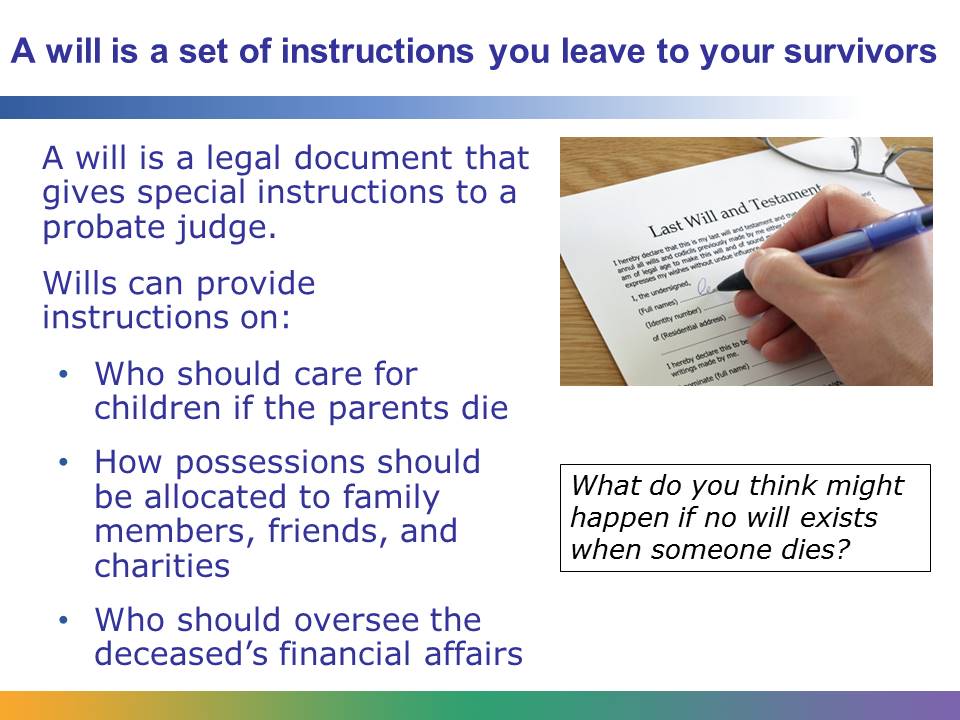
Estate planning principles and laws have been developing over thousands of years. Even the ancient Egyptians had complex estate planning!

One of the most common and important estate planning tools is the will. Among the important questions a will can answer are ”Who gets my stuff when I die?” and “Who will take care of my kids if I die unexpectedly?”

Another important tool is power of attorney. It answers the question of who makes medical and financial decisions for me when I am too ill to make them myself.

Financial planners or estate planning attorneys can help clients to prepare by advising them on the steps necessary to write a will, to create a trust, to give a trusted person power of attorney, and to choose someone to take care of their children if they die.

Together, these tools can help make tough times a little more smooth.



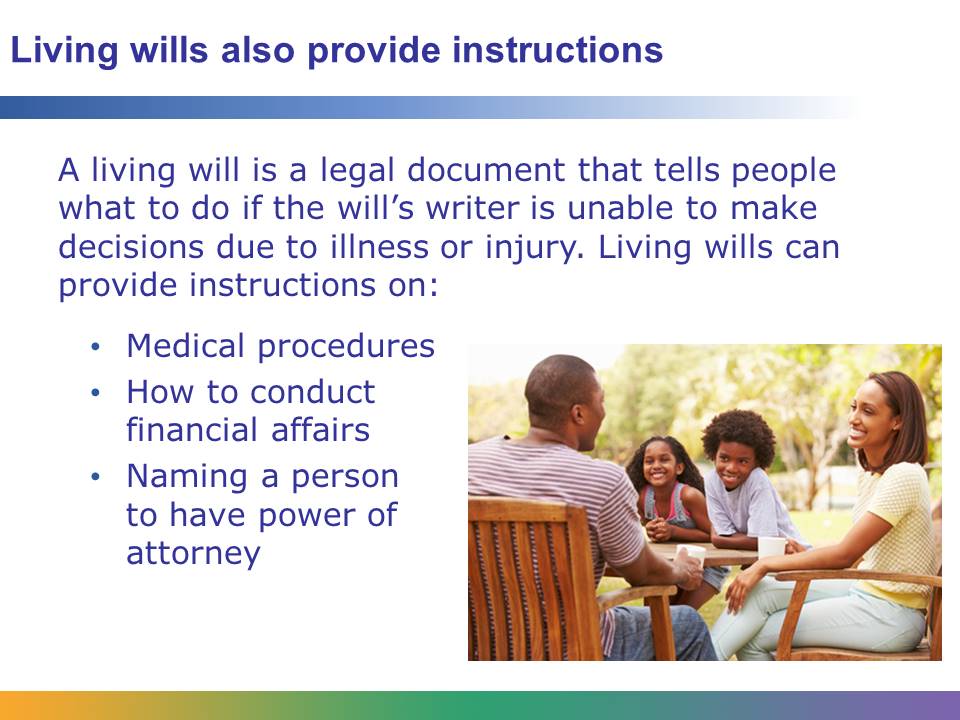
Perhaps you’ve read in a book or seen in a movie the dramatic moment when the contents of a will are opened up and people are waiting anxiously to hear what is in it.

Wills are legal documents that provide a variety of instructions that are to be carried out by the will’s executor (the person assigned in the will to ensure that it is carried out). It is one of the most important estate planning tools.

It is not difficult to write a basic will. In some places, a simple handwritten will is permissible. However, because a will is a legal document, it is a good idea to get advice from a lawyer in creating a will. In most places, the signing of the will has to be witnessed by others to help prove it is authentic.

The most common instructions in a will are about how to distribute assets to family, friends, and charities. Some wills provide instructions on who should take care of minor children. Some even provide instructions on how to take care of pets.

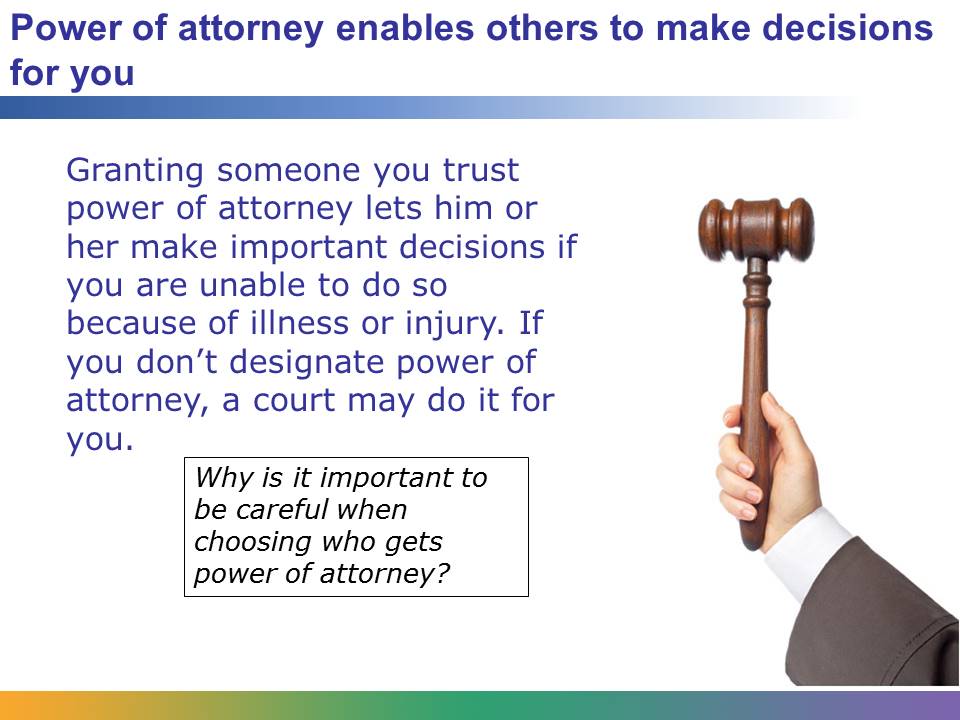
While the image of relatives waiting breathlessly to find out the contents of a will is a staple of fiction, many experts recommend that the instructions contained in wills not be kept a secret, to avoid family disputes after the will is read.



A will is a legal document used to provide instructions after a person’s death, and a living will is a legal document that provides instructions while the person is still alive but too sick or injured to be able to make medical and financial decisions on his or her own. For example, one common type of illness that can prevent seniors from making important decisions is Alzheimer's.

A living will usually contains instructions for doctors on what medical treatments the person wishes to have (or not have) performed. A living will can also contain instructions for assigning medical power of attorney or assigning a trusted person to make important medical decisions.

Note that in some states (Texas, for example) the term health care directive is used instead of living will. As before, a brief consultation with an attorney can help ensure that you do not create a document that has no legal authority.

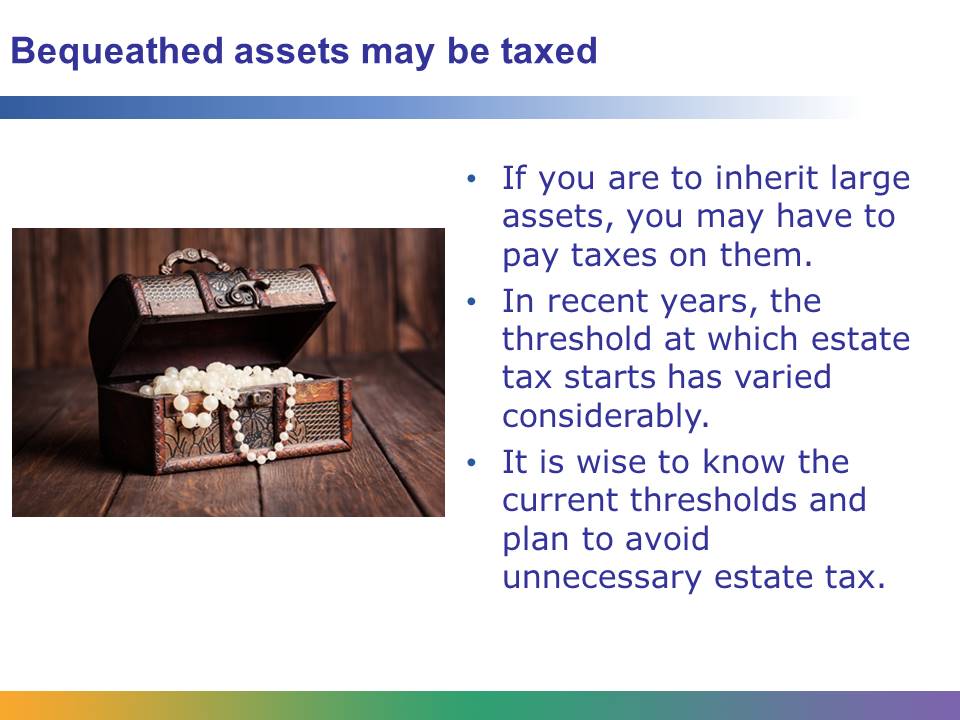


In addition to medical power of attorney, people can assign a durable general power of attorney for property in order to allow others to make financial decisions for them or even to administer all of their financial affairs.

There are two kinds of durable general powers of attorney for property (which includes financial affairs):

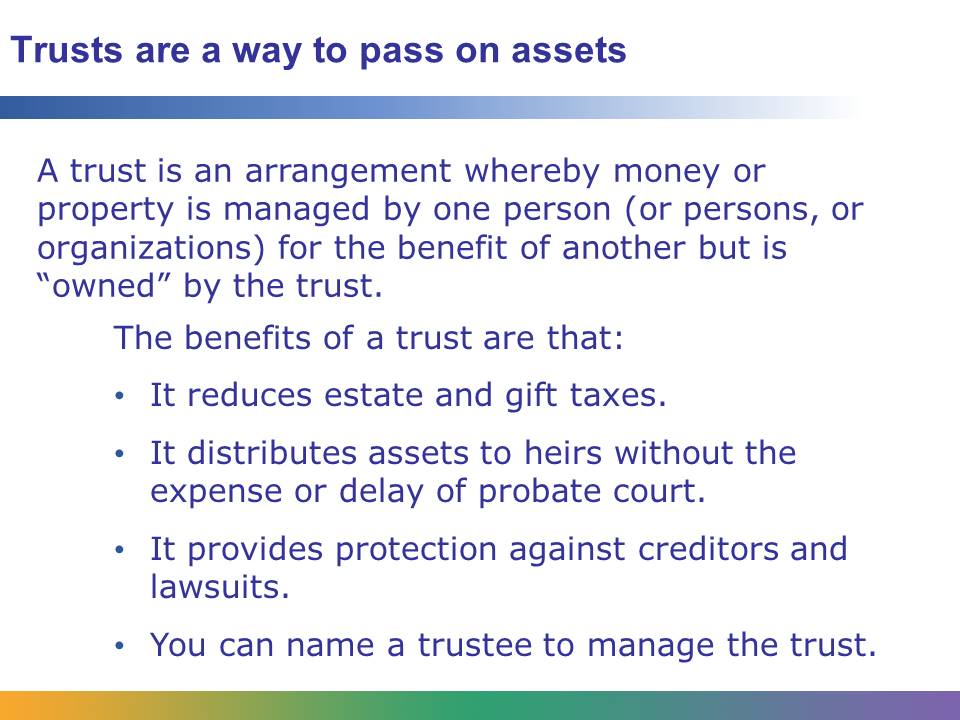
* Springing: The power of attorney becomes active if the set event occurs, such as an incapacitating illness or injury. Springing power of attorney only lasts until the person is capable of making decisions on his or her own again.
* Nonspringing: The designated person is assigned power of attorney immediately and for a set period of time.

Most states give financial institutions wide latitude to reject a power of attorney. It is very important to confirm in advance with your financial institutions that they will accept powers of attorney.



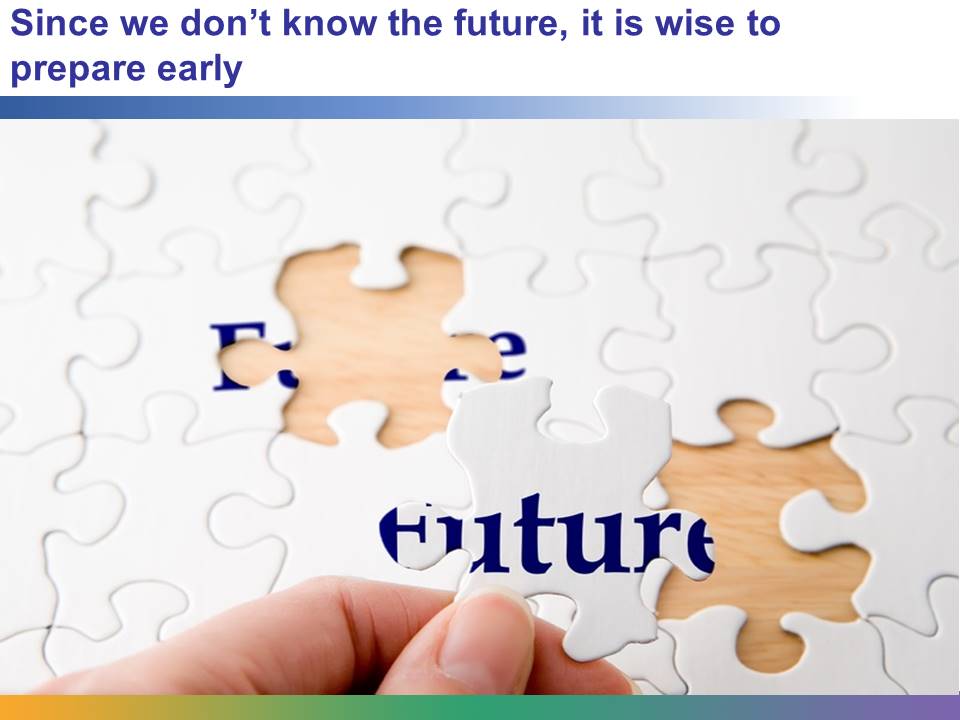
Assets that were passed on after death historically have been taxed with an estate tax if they exceeded certain thresholds. This threshold is called the exemption amount. Estates over this amount are subject to the tax. If a person has assets over the exemption amount, it is wise to plan so that taxation on the assets is reduced.

It is very wise to stay current with the thresholds so that the best strategies can be used to reduce any estate taxes. In 2014, the federal exemption amount was $5.34 million per person. Keep in mind that some states impose their own estate taxes that are completely separate from those imposed by the federal government, and the exemption limits of many states are significantly below the federal exemption limit.



One important way to pass on assets that can also reduce the taxes paid is through the creation of a trust.

A trust creates a legal arrangement whereby one entity, known as the trustee, holds and administers property for another entity, known as a beneficiary. The goal of the trust is to protect the assets placed in the trust and to distribute money or property to the beneficiaries. The creator of the trust has ultimate control in setting up the trust: determining what assets will be transferred into trust, who will serve as trustee while the person is living and after that person’s death, and how the trust property will be administered during or after that person’s lifetime. The creator of the trust assigns trustees, who benefit from the trust but who own the trust. The trust also assigns benefactors who benefit from the trust. The assets in the trust (often real estate) are not taxed directly, but the beneficiaries can utilize the rents, interest, and so on of the trust assets (though these are taxable).



An important role of the financial planner is to encourage clients to think ahead, even about things they may be uncomfortable pondering.

While most financial planners don’t write wills or create trusts (usually a lawyer handles these tasks), it is often the role of the financial planner to educate and encourage people to prepare for their future.

Student Resource 19.2

Scenarios Activity: Estate Planning in Practice

Student Name:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Date:\_\_\_\_\_\_\_\_\_\_\_

Directions: Read each of the scenarios below carefully, and then answer the questions that follow.

Scenario 1: Living Wills and Power of Attorney

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| hispanic_lady | Graciela Moreno is a little worried. Lately she’s been having headaches, and they make her think of her husband, who died five years ago after several serious strokes. When he was in a coma, she was able to make financial and medical decisions for him. Now that she’s alone, she worries that if she is unable to make decisions, there is no one to help her.  Today she is having coffee with a close friend, and they are discussing living wills and power of attorney. Graciela has known Carmen for many years, and admires her honesty and bravery. Graciela explains to her friend Carmen that she has written a living will to provide instructions to doctors and others about her wishes in case an illness or injury leaves her unable to make decisions herself. She asks Carmen if she would be willing to assume power of attorney if she were to become incapacitated. She explains that this would mean that Carmen would be entrusted to make important decisions about Graciela’s medical procedures and her investments and other financial matters until Graciela got well enough to make them herself.  Carmen is both honored to be asked and a little unsure of what is required. Graciela explains that she will leave some basic instructions as to her wishes in the living will and will spend some time going over her finances with Carmen so she is more prepared.  **What do you think?**  What characteristics would you look for when choosing someone to have power of attorney for you?  If you were chosen to have power of attorney for someone if he or she were sick or injured, what might you want to know beforehand?  Do you think a married person needs to give his or her spouse power of attorney, or do spouses automatically have that ability? |

Scenario 2: Trusts

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| mature_couple | Anthony and Cleo are sitting across from David, who has been their financial planner for the last year. Together they are discussing the best ways for the couple to pass on their assets and properties when they die to their two grown children.  Anthony and Cleo have a little problem—they own three houses, their own home, and two rental properties—and they have only two children. They foresee some jealousy and hurt feelings if they don’t split their inheritance equally. Also, they want to avoid leaving the children with too much in taxes to pay on their inheritance.  David discusses with the couple the benefits of placing the properties in a trust. A trust would mean that the properties belong to the trustees, which includes the children, but not to the children directly. This means that income from the rental properties would be available for the children, but the houses would not change hands after their death and thus they would not be taxed. They would only be taxed if the trustees decided to dissolve the trust. Another advantage of putting the properties in a trust is that the issue of the properties would not be decided in probate court, thus simplifying that process.  David also suggests that Anthony and Cleo begin making gifts of up to $13,000 to each of the children every year. Gifts up to that amount are not taxable. He also lets them know that any money they pay directly to educational institutions or health care providers for their children or grandchildren is tax free.  **What do you think?**  What advantages would there be in placing the properties in a trust instead of just bequeathing them to the children?  Is it important to discuss your heirs’ inheritance with them? Why or why not? |

Scenario 3: Will

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| family | In the back room of John Lamott’s financial planning practice, two little girls are drawing in coloring books. They are two of the three young daughters of Rick and Katrina, who are meeting with John to discuss writing their will. Together, John, Rick, and Katrina are reviewing the couple’s balance sheet.  While the couple is planning to eventually see a lawyer to write the will, they want John’s advice about the financial aspects of the will.  Rick and Katrina want to write a will for three reasons, the most important of which is that they want to assign a guardian for their three children in case both of them die unexpectedly. They also want to be able to choose who will get their assets if they die; this includes not only their three children but also a special charity that serves the blind. Katrina’s mother was blind, and she received a lot of help in her later years from this wonderful organization.  Finally, they want to make sure that their finances are in order if they die and that as few of their assets as possible are spent paying for probate court or taxes.  **What do you think?**  Are wills only for the wealthy? Explain your answer.  Many people die before making a will. What are some of the negative things that can happen if one dies *intestate*, which means without a will?  Why is having a balance sheet listing all of your assets and debts an important first step in creating a will? |