Janus Henderson
INVESTORS

FOUNDATIONS OF ESTATE PLANNING GUIDE

Creating an estate plan is an important part of managing your wealth. To help simplify the process, our Wealth Strategies team has created a three-part **Foundations of Estate Planning Guide.**

In Part One, we address investors at all wealth levels who are just beginning the planning process. Part Two is for those concerned about the fundamentals of transfer tax planning, exemptions, and rates of gift and estate taxes. Part Three discusses techniques commonly used by investors to reduce or eliminate transfer tax liability.

While this educational tool is not intended to provide tax or legal advice, it can help investors prepare for wealth transfer issues and decisions commonly faced by families. The lists below should be viewed as a framework. While the steps are presented in three parts, they may be completed or reviewed individually based on your specific situation.

PART 1

Beginning the process

Develop goals

Perhaps the most important part of the estate planning process is to develop and clearly state your goals. Mapping out your goals early in the process can help save time and money over the long run. Consider the following questions:

- Who are the recipients of wealth to be transferred?
- Are you interested in passing on a portion of your wealth while you are alive?
- Is there a chance any of your assets could become subject to creditor claims (yours or your beneficiaries') in the future?
- If you have more than one beneficiary, do you anticipate leaving equal or unequal shares?
- Do you have any specific gifts in mind, such as real estate or personal property?
- Do you intend to leave anything to religious institutions or charities, and if so, which ones?

Make an inventory

Your estate plan should account for each of your family members as well as all your assets and liabilities. It will take time to ensure that you capture this information, but the more comprehensive the inventory, the more likely your completed plan will accomplish your goals. Basic information you will need includes:

- A list of each family member (by blood and marriage) and contact information if available; additionally, identify any family members with disabilities or receiving public aid
- A listing of each asset and liability (i.e., home, car, life insurance, savings account, brokerage account, retirement account, mortgage, margin loan, etc.)
- The name or title of the asset or liability (single name, joint, etc.)
- The cost basis of assets listed (typically the purchase price)

Choose an estate planning attorney

Choosing the right estate planning for your situation is critical to ensure your plan reflects your wishes. The most common way people find an attorney is through a referral from a financial advisor, a family member, or friend. As an alternative, the local bar association, or professional associations such as the Estate Planning Council, may also be helpful resources. Questions to ask prospective attorneys include:

- How long you have practiced trust and estate law?
- What percentage of your practice is dedicated to estate planning?
- Describe your last three estate planning engagements. Are they similar to this one?
- What are your fees and expenses?
- Can you project a timeline for completion of the plan?

Execute documents

While every situation is different, there are common documents found in most estate plans.

These documents include:

- **Last Will and Testament** facilitates the probate process, names an executor, names guardians for minors, ensures payments of outstanding debts, determines the distribution of probate assets, and provides for access to online "digital" assets
- **Durable Power of Attorney for Financial Matters** appoints an agent to make financial decisions in the event of your incapacity
- **Durable Power of Attorney for Health Care Matters** appoints an agent to make medical decisions in the event of your incapacity; other important medical documents include a living will and do-not-resuscitate declaration
- **Revocable Living Trust** provides for asset management during life and at death; may help avoid probate administration

Select fiduciaries

The legal documents described above are essential tools, but naming the right executor, trustee, guardian, and agent is critical. These individuals should be chosen based on their ability to make decisions that balance your stated wishes with the best interests of the beneficiaries. Specific considerations include:

- Is there one person who can serve in all these capacities? Do I want more than one at a time serving? (co-trustees, co-executors, etc.) What if they can't or won't serve? Are successors listed?
- Would my beneficiaries benefit from using a professional (corporate) fiduciary?
- Did I inform these fiduciaries of their appointment? If so, did I give them the opportunity to opt out?

Documentation and recordkeeping

Now that your foundational estate plan is in place, make sure that the documents are kept in a secure location and are easily accessible when needed. Common considerations include:

- Maintaining hard copies in a home safe or safety deposit box, with a backup set of documents with a trusted advisor
- Alternatively, many documents may be housed in the cloud in an electronic "vault"
- Whatever storage system is chosen, be sure to communicate the location and discuss with counsel whether to provide access to family members

Make updates

In most circumstances these documents can be changed, updated, or amended as needed. Typically, individuals update their estate plan following life events such as the birth of a child, the death of a spouse, divorce, move to a different state, or sale of a business. In these circumstances, contact your estate planning professional as soon as possible to ensure your estate plan accounts for these changes in your life.

PART 2

Fundamentals of transfer tax planning, exemptions and rates of gift and estate taxes

1. What transfers are taxable?

A transfer of assets (i.e., real estate, financial assets, personal property) from one person to another usually takes the form of either a sale or a gift. In either case, it is safest to begin with the presumption that all transfers of property are subject to some type (often several types) of tax. Sales can be subject to income tax at the federal, state, and local levels. Additionally, certain types of assets such as real estate may require payment of a stamp tax or real estate tax. Gifts made during life can be subject to gift tax and generation-skipping transfer tax. Gifts at death may be subject to estate tax and generation-skipping transfer tax. **Part 2 of this guide focuses on the taxes assessed on lifetime and deathtime gifts, which can also be levied at the federal, state, and local levels.**

2. What taxes apply?

Transferring an asset for something less than its fair market value results in a gift from the gift maker (the Grantor) to the gift recipient (the Grantee). If the transfer is between two living people, a gift tax applies. If the transfer is made from the estate of a decedent to a living person, then estate tax applies. If the recipient is more than a single generation removed from the Grantor, a generation-skipping tax is assessed. Federal gift and estate taxes are the most well-known, but many states and some municipalities also levy gift and estate taxes. As a result, seeking professional advice prior to making significant gifts is wise.

3. What tax rates apply?

At the federal level, gift and estate taxes are assessed at the flat rate of 40% of the value of the asset gifted. State gift, estate, and inheritance tax rates vary and are in addition to the federal tax. Note that gift taxes are payable by the gift-maker or Grantor and are in addition to the value of the gift.

4. What exemptions apply?

Several exemptions, deductions, and exclusions can apply to lifetime and deathtime gifts, which can significantly reduce transfer tax liability.

- **Unlimited marital deduction:** A 100% deduction is allowed for gifts between legally married spouses if the gift recipient is a U.S. citizen or a Qualified Domestic Trust for the benefit of a non-U.S. citizen spouse.
- **Unlimited charitable deduction:** A 100% deduction is allowed for gifts to qualified charities. This deduction applies only for purposes of determining gift and estate taxes. Compare this to the more limited income tax deductibility of charitable gifts.
- **Educational and medical exclusion:** Payments made for the education or medical needs of the recipient are not subject to reporting or tax if they are made directly to the institution or provider. Gifts made to individuals and later used as payment for medical or educational expenses do not qualify for this exclusion and are subject to rules regarding gifts to individuals.

- **Annual exclusion:** The annual exclusion is that amount which can be given each year that does not require reporting and on which no tax is due. This amount is adjusted for inflation and is redetermined annually. To qualify for this exclusion, the gift must be immediately available to the recipient.
- **Gifts to 529 College Savings Plans:** 529 Accounts are income tax-advantaged accounts to encourage savings for education. Gifts to such accounts are subject to both the annual exclusion and lifetime exemption limits; however, the law allows Grantors to "pre-fund" such accounts with up to five years' worth of annual exclusion gifts without using the grantor's lifetime exemption.
- **Lifetime exemption:** Gifts more than the annual exclusion must be reported to the Internal Revenue Service on a gift tax return. The lifetime exemption allows gifts up to the permitted amount to be made gift-tax-free. This amount (or any part of it) can be used during life or at death. The value of reported taxable gifts made during life are added back to the taxable estate at death and the lifetime exemption then in effect is applied.

5. Special rules to keep in mind

For gifts made during life:

- Annual exclusion gifts: Amounts gifted, plus future appreciation, are generally removed from an individual's gross taxable estate at death; must be a gift of a "present interest"
- Lifetime exemption gifts: Only future appreciation is removed from an individual's gross taxable estate at death
- Gifts of appreciated assets (i.e., marketable securities, real estate) will generally retain the Grantor's original cost basis (no step up in cost basis)
- Be aware of state gift taxes

For gifts made at death:

- Stepped up cost basis on assets included in decedent's taxable estate; eliminates income-taxable gain upon sale
- A surviving spouse can preserve and later use a predeceased spouse's unused lifetime exemption
- Be aware of Community Property v. Common Law Property
- Be aware of state estate and/or inheritance taxes

PART 3

Techniques commonly used by investors to reduce or eliminate transfer tax liability

1. Estate tax planning breakdown

The federal estate tax can be most simply defined as a tax on the value of assets owned or controlled at death. As such, there are only three ways to reduce/eliminate the tax:

- Don't own or control the assets at death
- Reduce or minimize asset value
- Make a 100% deductible transfer

All estate tax planning solutions employ one, two, or all three of these strategies.

2. Set, prioritize, and communicate goals

Every investor has a unique life experience and a very personal set of goals. If tax savings were "priority number one", estate planning would be easy: Leave everything to charity. Most investors prefer to enjoy their wealth and leave what remains to family and friends in a way that will enhance the recipient's life and reduce the administrative and tax cost of transfer. Once goals are prioritized, consider the following techniques for reduction of transfer costs.

3. Priority: "I want to provide for my spouse"

Spousal gifts: Deductible transfers, don't own or control the asset

The unlimited marital deduction eliminates estate tax on transfers to a surviving spouse. The following techniques take advantage of this deduction:

- Outright gifts clearly qualify for this deduction and allow maximum survivor access and flexibility, minimizing deceased spouses' control and survivors' asset protection.
- Marital trusts (commonly the "A trust" in an A-B trust plan) can provide a surviving spouse with varying degrees of access with some potential for deceased spouses' ongoing control and asset protection of trust assets.
- Qualified Terminable Interest Property (QTIP) Trusts are generally used to provide a surviving spouse with the minimum flexibility and control of inheritance while still qualifying for the marital deduction. This trust MUST contain certain minimum annual distribution requirements and allows the deceased spouse to control final distribution of trust assets upon the survivor's death. These are commonly used in second marriages with children from a prior marriage (QDOT for non-U.S. citizen spouse).
- Spousal Lifetime Access Trusts (SLAT) are irrevocable trusts established to receive a gift of the lifetime exemption. Beneficiaries include the non-grantor spouse and children or other family members. The goal is to be certain this trust does not qualify for the marital deduction. A SLAT is often proposed to use/preserve the grantor's lifetime exemption.

4. Priority: "I want to take care of my family/friends"

Strategic lifetime gifts: Don't own or control the asset, minimize value

These gifts can remove assets from the grantor's estate in an efficient manner.

- Outright gifts remove the assets and control from the gift-giver's estate. These gifts allow maximum control by the recipient. Often made for occasional gifts, to provide economic support, or provide a financial education teaching opportunity.
- Gifts to minors frequently take the form of non-trust solutions (UTMAs, 529 accounts) or irrevocable gift trusts such as 2503(b) or (c) trusts, which qualify as a present interest for annual exclusion gifts.
- Gifts to irrevocable trusts can provide both income and estate tax benefits, the most common being an Irrevocable Life Insurance Trust (ILIT). These trusts often include "Crummey powers," which allow application of the annual exclusion to gifts to the trust.
- Split interest gifts such as Grantor Retained Annuity Trusts (GRAT), Grantor Retained Unitrusts (GRUT), and Qualified Personal Residence Trusts (QPRT) reduce the reportable value of gifts to the remainder beneficiary while reserving an ongoing revenue stream for the grantor.
- Fractional gifts of interests in Family Limited Partnerships (FLPs) and Limited Liability Companies (LLCs) allow the grantor to retain control and discount the value of gifts to loved ones.

5. Priority: "I want to give back to society"

Strategic charitable gifts: Don't own or control the asset, deductible transfers

- Outright charitable gifts provide the greatest freedom to the charitable recipient. Gifted assets are removed from the estate. Maximize income tax deductibility by gifting appreciated assets, making Qualified Charitable distributions from IRAs.
- Donor advised funds (DAFs) and Community Foundations allow the opportunity to "bunch" charitable gifts in a single tax year, maximizing income tax deductibility, while spreading distributions to end-charitable causes over time. They promote accountability on behalf of the charity.
- Charitable trusts (private foundations) provide multigenerational management and control of contributions as well as distributions. However, greater control could create less income tax deductibility.
- Split interest charitable trusts provide charitable and non-charitable benefits in a single trust.
  - Charitable Remainder Trusts (CRAT, CRUT) provide the Grantor income tax deferral and an ongoing revenue stream; remaining assets are donated to charity.
  - Charitable Lead Trusts (CLAT, CLUT) the Grantor to reduce gift tax liability while providing charities with an income stream for a period of years.
- Charitable gift annuities are a non-trust split-interest solution. A gift is made to a charity that uses a portion of the gift to purchase an immediate annuity for the grantor. Income tax deductibility is the net value of the charitable gift.

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