The New Era of Estate Planning

For advisors, the beginning of the year is a good time to follow up with clients and help them revisit the basics of estate planning as well as to flag new trends and legislation. This year is no exception. New presidents are often accompanied by new policies, and with tax season on the horizon, the next few months are a great time to review and possibly revise current plans.

There are four estate-planning best practices that are worth addressing with clients regularly, but there are also two new issues advisors must be aware of this year.

Staying updated about upcoming changes. We have a new president, and there has been much discussion about the possible demise of the "death tax." President Donald Trump's plan calls for a repeal of the current estate tax, and a capital gains tax on estate assets in excess of $10 million with an exemption for family farms and small businesses. There is some discussion about whether the capital gains tax would be payable upon the death of the property owner, or upon the sale of the asset by the inheritor. Regardless, this would represent a change in the top tax rate from 40% (estate tax) to 20% (capital gains tax), a significant reduction for individuals and families impacted by the change.

Another potential change in the tax legislation involves the possible elimination of the "stretch IRA." Under the current law, a beneficiary inheriting an IRA can opt to "stretch" the distribution of the account over his or her life expectancy, thereby deferring the payment of taxes on withdrawals for many years.

Last fall, the Senate Finance Committee passed proposed legislation called the Retirement Enhancement and Savings Acts of 2016 (RESA), which eliminates the stretch IRA, requiring individuals who inherit IRAs to withdraw funds over the five-year period following the original owner's passing. This proposal applies only to balances in excess of $450,000, and is estimated to generate over $3 billion in additional revenue through 2026. *(See "Why Estate Planning Still Matters in an Uncertain Tax Environment" for more on tax management in estate planning.)*

Ensuring access to digital assets. We live in a digital age, and the growth and definition of digital assets are a challenge for the estate planning industry, which is used to operating with physical and tangible assets. Nevertheless, the proliferation of digital tools over the past few decades has created assets and property worth preserving, despite their temporality and difficulty to value. It is up to advisors to create a true framework to ensure that such property is protected.

Some digital assets are familiar. These items include downloaded content and uploaded original property, such as photos and videos. Other types, however, are more complex, such as domain ownership or digital currencies like bitcoin.

One major obstacle to collecting and protecting digital assets within an estate plan comes from the ability to gain access to them. There are at least four significant, unique obstacles to accessing digital assets that aren't encountered when dealing with more traditional types of assets: passwords, data encryption, legal authorization laws and data privacy laws. All of these can complicate retrieval of the asset by the family or fiduciaries, even if the asset should be accessible to a loved one. In the case of digital assets, access should never be taken for granted, and can be revoked or restricted depending on laws, service providers or other agreements.

Currently, the Revised Uniform Fiduciary Access to Digital Assets Act by the Uniform Law Commission provides the clearest legislation on access to digital assets. In the most recent revision of the Act in 2015, estate representatives may not obtain the contents of a deceased's electronic communications unless that person has consented to the disclosure. So far, legislation governing access to digital accounts in the event of the account holder's death has been introduced in at least 32 states, and at least 20 states have enacted such laws, according to the National Conference of State Legislatures.

As an advisor, the recommendation for clients should always be that they keep a list of passwords to digital accounts in a safe place, and to have some notion of what types of digital assets they would like to have preserved and open or restrict access for.

Once you've established a full understanding of the client's digital assets, it is helpful to examine the transfer restrictions on his or her digital accounts, and incorporate specific authorizations in powers of attorney, revocable trusts, wills or other estate documents.

ESTATE PLANNING BEST PRACTICES

Clarify the intent of estate planning. Everyone has an estate plan, even if they haven't created one. For those who do not explicitly create an estate plan, the state in which they live has one for them by default.

Getting clients to understand how this default plan would impact them personally is usually an impetus for them to create their own estate plan. More often than not the default plan does not properly address and may even oppose the wishes of the client. Estate plan reviews should take place at least every three to five years and during major life changes, such as births or deaths in the family, marriage, divorce and retirement.

Many clients mistakenly believe that creating an estate plan means they are expected to make decisions they are not ready to make. This is far from the truth, and advisors can assist by breaking the planning process into segments that are easily understandable to the client. Start with the basics, then branch out into more complicated sections that require deeper deliberation. Even if the client is hesitant to make more complex decisions, at least there is a basic plan in place that will carry out their wishes.

It is always worthwhile to take the extra step of asking clients to detail a brief history of their wealth, to write a letter of intent to beneficiaries, or even to put into place incentives that can help guide the chosen fiduciaries and the future generations of the estate who will receive its benefit. This ensures that the estate plan remains true to your client's wishes, perhaps with emphasis on education or charitable giving, along with other intents. It is also worthwhile to run through a number of "what if" scenarios to help ensure the client provides instructions for a variety of circumstances that may occur.

Insist on reviewing asset titling. You can't be too thorough when it comes to asset titling in estate planning. Thoughtful estate plans can be derailed by not paying close attention to how assets are titled. Naming the eldest child to represent all children, or adding individuals to accounts as a convenience without consideration that they could be viewed as an account owner, are examples of issues that may need to be addressed. Additionally, neglecting to look at the bigger picture will likely result in lopsided titling and will not reflect the true intent of the client. A careful review should be done for every major asset and account, including life insurance, pensions, IRAs, executive compensation plans and annuities. Titling should be reviewed on a regular basis and especially after life changes.

Trying to undo undesirable titling after a client passes away can result in unintended probate, additional expenses, long delays and, perhaps most importantly to many clients, the loss of privacy. All of these are easily avoidable consequences, and advisors should emphasize the importance of getting it right the first time.

If using trusts, clients must also remember to retitle assets in the name of their trusts. This can get confusing if multiple trusts are in play (such as a living trust for each spouse), so it is crucial that the client is certain and clear on what assets will be controlled by whom in a particular trust. This is particularly important for clients who own property across more than one state, as improper titling could result in undesired probate in multiple states.

Make a contingency plan for disability. Most clients do not like the idea of planning for disability. After all, they've already "prepared for the worst" by estate planning. Nevertheless, planning for disability is a critically important part of the planning process. Here's a point that advisors should drive home to their clients — it is much more likely for the average person to become disabled than to die prematurely. If this happens, and the disability prevents the client from adequately caring for his or her family, managing financial affairs or working, there must be a contingency plan in place to address those needs.

Perhaps the most important consideration is the possible loss of income resulting from a disability. Typically, disability insurance helps cushion the potential impact, and advisors should work with their clients to calculate the need and the amount of disability insurance that would be appropriate.

Next are the powers of attorney. Without specified powers of attorney, there can be costly and time-consuming proceedings by the court to determine who will manage the health and financial matters of the client and their dependents. Many advisors will recommend using a revocable living trust for this assistance with the management of property. However, the trust can only control assets titled in the name of the trust, so it is crucial that the client title assets correctly, and to plan for the management of any financial assets which may not be part of the trust.

Another area that should be part of your planning discussion involves looking at life insurance coverage. Many clients have not considered the multiple ways that life insurance can fit into their financial plan. Common uses for insurance include paying off debt (including a mortgage), funding education for children, or as a wealth replacement tool to make a taxable estate “whole” after payment of estate taxes. If structured correctly, the proceeds of a life insurance policy can be paid free of estate tax by utilizing an irrevocable life insurance trust established during the client's lifetime. Life insurance may also provide critical liquidity for the payment of estate taxes for business owners whose families can face serious issues when a business owner has not planned properly.

For example, problems can arise if a business owner passes away unexpectedly leaving a large estate tax burden, no succession plan and little liquidity to cover the tax bill. This type of scenario may force the sale of the business against the family's wishes and possibly at a “fire sale” price.

Choose the right fiduciaries. A successful estate plan very much hinges on having the right representatives to carry out a client's wishes.

Aside from a capable financial advisor, a well-chosen estate-planning attorney is key. The estate planning documents are the only guide for the trustees to direct the management and transfer of wealth, and poorly drafted documents will cause many challenges and confusion. The potential for issues only grows as the value of the estate increases. Furthermore, the chosen attorney does not only work for the client, but also the client's survivors and other named fiduciaries. The attorney should be a trusted choice for the client, and his or her entire extended family.

When it comes to choosing the right fiduciaries of the estate plan, many clients make decisions based on personal relationships and an assumption of willingness or competency. It's important to understand that considerable demands are placed on the fiduciary, and that it can feel like a full-time job to act as one. At a minimum, the duties are time consuming and include the oversight of legal and tax matters, handling disbursements, maintaining records, reporting to beneficiaries and managing assets. It is not a role to be taken lightly or chosen based on convenience. Clients often favor a close family member or friend, but a fiduciary may feel heavily pressured by the family or lack the skills to understand business and legal matters.

Advisors should present the choice of a corporate fiduciary to clients, as they may benefit from more experience, objectivity and technical knowledge. Of course, a corporate trustee may lack an intimate understanding of the family and its dynamics. A balance can be reached for the client using a corporation (bank or trust company) in combination with an individual serving as a fiduciary. The corporation can fulfill the administrative, tax, legal, investment, recordkeeping and reporting duties of the trustee, while the individual fiduciary can have influence over more personal decisions such as discretionary distributions from the trust to the inheritors as outlined in the trust agreement. This combination can be especially important when the estate has significant value or involves complex client situations or assets (business interests, real estate and valuable collections).

There is no time like the present to help assure your clients that they have a current and effective estate plan in place. One thing we can all be sure of is that the future will certainly bring change. Helping your client prepare for those changes is one of the most important services you can provide.

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