Strengthen Your Legacy

Estate Planning Basics

West Coast Life Insurance Company
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Strengthen Your Legacy

Estate Planning Basics

Americans are famous for their dreams.

Our founding fathers dreamed of freedom, equality and prosperity. Your parents dreamed of owning a home, driving a nice car, and raising children. You might dream of summers at the beach, paid college tuitions and a better future for your kids.

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For centuries, hardworking families have been busy turning one generation's dream into the next generation's reality through good planning. Working hard and passing on the fruits of your labor is an American tradition that has endured through wars, recessions and economic booms. In these challenging times, it's more important than ever for families to begin planning so they can properly preserve and pass on a legacy to their loved ones. A solid estate plan can provide a family as much stability as possible when the future seems so uncertain.

Understanding basic estate planning is the key to building your dreams and strengthening your legacy.

An estate plan can be as easy as drafting a simple Will, or as complex as establishing several different types of trusts to serve different purposes. In this overview, we'll explore why you should consider an estate plan, and the basic elements of an estate plan.

There are four places your wealth can go by the time you pass away:

1. *You have spent it all*
2. *To your loved ones (heirs)*
3. *To the Internal Revenue Service (IRS)*
4. *To charity*

How your wealth will be distributed among these four areas will be determined by the steps you take, or don't take, to strengthen your legacy now.

Estate planning—Not just for the wealthy

When most people think about estate planning, they dismiss it as something only for the wealthy. The truth is, estate planning is important for anyone who wants to preserve a legacy for loved ones. Have you recently gotten married? Do you have children? Are you thinking about retirement? These are all good indicators that it's time to create an estate plan. If you have property—a house, a collection of jewelry, liquid assets—you need to plan for what will happen to those assets after you pass away. Estate planning also includes taking steps that may be important for your family's security while you are still living. For example, a basic estate plan should include completing documents that may be activated when you are incapacitated, or suffering a severe medical condition. Documents would include a durable general power of attorney, a health care power of attorney, and perhaps an advance medical directive ("living will"). An estate plan can help protect the assets you have worked hard to build from unnecessary costs and excessive taxes.

Estate planning includes the steps for the administration and disposition of your property after you pass away. Most people are uncomfortable with the question, "What would happen if I died today?" But creating an estate plan now can give you and your family peace of mind when faced with that reality.

Special Comment Concerning Current and Future Estate Tax Laws:

Federal estate, gift and generation-skipping transfer tax rules are subject to change at any time. Under current law, if your death occurs after 2010 and your net taxable estate exceeds $1 million, your estate is subject to a 55% tax rate (higher for very large estates). For persons who die during 2010, federal estate taxes do not currently apply. However, proposals in Congress could (if enacted) impose new estate tax rules that may be applied retroactively to January 1, 2010. Determining your net taxable estate involves adding up all your property, including your life insurance death benefits, and then subtracting certain expenses, debts and liabilities that may be deducted from your gross estate. Even if your estate is not subject to federal estate taxes, it may nevertheless be subject to state estate and/or inheritance taxes, depending on where you are domiciled and where your assets are located at the time of your death.

A proper estate plan can help:

- *Preserve your assets*
- *Reduce wealth transfer taxes and expenses*
- *Distribute your assets properly and economically to the beneficiaries that you specify*
- *Ensure that your children have the legal guardian of your choice*
- *Ensure that your assets will be managed properly if you were to become disabled*
- *Minimize confusion and avoid conflict among family members when it comes to your final wishes*

The role of life insurance in estate planning

Permanent life insurance can be a powerful tool in estate planning. It can provide income replacement and family protection. The death benefit of a life insurance policy usually passes to the beneficiaries free of income tax, providing the cash a family needs to pay taxes, debts, and other obligations when a loved one passes away.

Life insurance can allow you to:

- *Give loved ones an income source after the death of an income provider or caregiver*
- *Provide cash to pay estate taxes, mortgages and other expenses*
- *Take advantage of the annual gift tax exclusion, or effectively use your Generation-Skipping Transfer Tax (GSTT) exemption**
- *Create an estate for your loved ones*
- *Leave a substantial benefit to the charity of your choice*

If you answer **yes** to any of the following questions, you need to consider beginning an estate plan:

- *Do you own property?*
- *Do you have dependents?*
- *Do you own a business?*
- *Are you worried about what would happen to you and your estate if you were to become incapacitated?*
- *Is it important to you to pass on wealth to your loved ones?*
- *Do you own assets that may be subject to tax and want to minimize taxes involved in transferring these assets?**

Getting started: Your Will

A Last Will and Testament is a personal declaration of your intentions about the distribution of your property at death. Although it is a critical piece of an estate plan, nearly 60% of Americans do not have a Will[1].

A Will does not become legally enforceable until your death, so it may be changed at any time before your death or mental incompetence. A properly drafted Will contains instructions for your personal representative or the executor—the person who will administer your estate.

Your Will allows you to:

- *Name the executor and successor executors of your estate*
- *Designate a guardian for your minor children or other dependents who are unable to care for themselves*
- *Control the distribution of your assets*
- *Contribute some or all of your estate to charity*
- *Minimize federal estate taxes (and possible state estate and inheritance taxes)**
- *Reduce confusion and stress for your family at the time of your death*

What happens if you don't have a Will?

Dying without a Will is considered dying "intestate." Dying intestate can create unnecessary costs for your heirs, and gives you no control over who receives your assets or how they should be distributed. Certain assets with already designated beneficiaries, such as life insurance or an individual retirement account (IRA), will go directly to your beneficiaries. But other property and assets will be distributed according to your state's laws, which may not reflect your intent or what is best for your family.

What are the risks of NOT having a Will?

- *Your assets not being distributed as you wish*
- *A person you do not know could act as your personal representative*
- *A guardian you did not choose could end up raising your children*
- *You may miss out on tax-saving opportunities, leaving your heirs less than you intend**
- *Your children may receive their inheritances earlier than you'd like*

* Please see Special Comment Concerning Current and Future Estate Tax Laws on page 1 of this brochure.

[1] http://west.thomson.com/about/news/2008/06/30/findlaw-survey.aspx, "Most Americans Don't Have a Will, Says New FindLaw.com Survey"

Remember to review your Will regularly.

Once you have made a Will, be sure to review it regularly. Significant changes, such as births, deaths, marriage or divorce, are reasons you may want to review and modify your Will. Changes to your financial situation or tax laws may also be good reasons to update your Will. **Below are reasons to make an update:**

- *The individuals you have named in your Will have passed away, or you may have new family members that you want to include in your Will (births, adoptions, etc.)*
- *Your children have reached age 18, and are no longer minors*
- *You have gotten married or divorced*
- *New state laws that could impact your estate planning documents*
- *Relocation to a different state may call for changes in your Will to comply with the requirements of your new state*
- *You have had a change in guardians, personal representatives, or trustees*
- *You have experienced a substantial increase or decrease in the value of your estate*
- *You have reached age 70 ½—If you have an IRA, 401(k), or other qualified plan, you should see an attorney about reviewing and updating your estate plans prior to reaching 70 ½ years of age*
- *As a general rule of thumb, you should review your will and estate planning documents every three to five years*

The Basics of Trusts

Trusts can be an important element of your estate plan. Establishing a trust can help you avoid probate, provide financial support to loved ones, and maintain privacy if your state requires the filing of an inventory of assets in probating your Will.

Trusts involve the transfer of your property to an individual or corporate entity (the "trustee") who manages the assets within the trust's control for the benefit of one or more beneficiaries. A living trust is one that is effective during your lifetime, and is ordinarily not irrevocable, but instead may be revised from time to time until your death, or even revoked entirely. A testamentary trust is a trust whose provisions are included in your Will and does not become operative until your death, when your Will is probated by the courts.

What can you gain from establishing a trust? The benefits of trusts vary according to the type of trust chosen, but most trusts give you the following benefits:

- *Professional management and investment of your trust property*
- *Specific conditions on how and when your assets will be distributed to your heirs, based on your instructions*
- *Provisions that can help minimize gift and estate taxes**
- *Allow your assets to be distributed to your beneficiaries without dealing with the delay, expense and publicity of probate*

Just as a Will can be changed prior to your death, in general, the terms of your trust can also be modified. Living trusts can be set up as revocable or irrevocable. In a revocable trust, the creator of the trust (the "grantor") can make changes to the trust. But the trust assets within an irrevocable trust no longer belong to the grantor; they are owned by the trust entity.

** Please see Special Comment Concerning Current and Future Estate Tax Laws on page 1 of this brochure.*

One of the most powerful estate planning strategies is the unlimited marital deduction. Any property that passes from one spouse to the other upon the death of the first will pass tax free, as long as the surviving spouse is a U.S. citizen. So, if you wish to transfer all of your assets to your surviving spouse, there will be no federal estate tax due on the first spouse's death.

The Marital Deduction

One of the most powerful estate planning strategies is the ***unlimited marital deduction***. Any property that passes from one spouse to the other upon the death of the first will pass tax free, as long as the surviving spouse is a U.S. citizen. So, if you wish to transfer all of your assets to your surviving spouse, there will be no federal estate tax due on the first spouse's death.* Transferring all of your property to your surviving spouse is not always the perfect solution for your estate tax problems. For instance, if the surviving spouse does not remarry, then he or she will not be able to use the marital deduction upon the later death. The assets transferred from the first spouse might be subject to tax on the survivor's estate, depending on when the surviving spouse dies and the law in effect at that time. In addition, the idea of your surviving spouse passing all of your assets to a second spouse may not be your preference, even if it saves estate taxes.

Since the marital deduction property is subject to estate taxes upon the death of the surviving spouse, you may want to consider another technique, the credit shelter trust.*

The Credit Shelter Trust

Even with the return of the federal estate tax in 2011 (or sooner if Congress enacts tax law change effective for 2010), married couples can plan to transfer a portion or

** Please see Special Comment Concerning Current and Future Estate Tax Laws on page 1 of this brochure.*

all of their property without federal estate taxes. With a properly designed estate plan, an amount equal to both of their exemption amounts can pass at death without federal estate taxes. By combining the exemption amount of both spouses dying after 2010, as much as $2 million of their assets may be passed without federal estate taxes. Although it is possible Congress will increase the exemption amount for 2011 or later years, there can be no assurance that such legislative change will in occur.

A *credit shelter trust* will provide a way to take advantage of each spouse's exemption amount while also providing the desired inheritance for your surviving spouse and children. It is a fairly common practice for each of the spouses to hold some assets in their individual names, so both spouses can fully use their exemption amount, regardless of the order of their deaths. With a credit shelter trust, the first spouse to die can shelter his or her full applicable exemption amount from federal estate tax. That amount will not be subject to federal estate tax again when the second spouse dies. And the surviving spouse will be in a position to use his or her exemption amount as well. This optimal use of both spouses' exemptions would not occur if all assets were transferred on the first death to the survivor.

Both a credit shelter trust and a marital deduction trust can be included in your Will, or in a revocable trust ("living will"). Unlike a Will, the revocable trust assets can pass to your survivors without the delays, costs, and procedures of the probate court process.

The Irrevocable Life Insurance Trust (ILIT)

An ILIT is an irrevocable trust created to own life insurance. If the trust is properly set up, the life insurance proceeds received by the trust should not be subject to income or estate taxes upon the death of the insured(s). An existing life insurance policy can also be transferred to an ILIT, but when doing so, special tax issues should be addressed with your tax advisor to avoid any unexpected tax consequences.

An ILIT can help you:

- *Provide cash for your beneficiaries, usually free of income and estate taxes, to fund estate taxes and other transfer costs*
- *Create a pool of assets to increase what your beneficiaries receive*
- *Protect the trust assets from creditors*
- *Provide for the effective management of insurance proceeds after your death*
- *Take advantage of the annual gift tax exclusion (the amount that a donor may give to each recipient in a single year, free of federal gift tax—$13,000 in 2010).*
- *Effectively use your Generation Skipping Transfer Tax (GSTT) exemption*

Leaving Assets to a Charity

As a general rule, outright gifts to charity at death are deductible from the decedent's estate without limit, reducing the taxable estate. The following are examples of how you can efficiently pass on your wealth to a charity through trusts:

The Charitable Remainder Trust

A *charitable remainder trust (CRT)* is an effective estate planning tool for those who hold appreciated assets with low basis, like stocks or real estate. Funding this trust with appreciated assets allows the donor to transfer the appreciated assets without incurring a capital gain. CRTs provide you with an efficient way to transfer appreciated property, benefit from the charitable income tax deduction, and reduce estate taxes.

There are two sets of beneficiaries named in a CRT: the income beneficiaries and the charities you name. The income beneficiaries are those persons who receive income from the CRT during its term. The most typical income beneficiaries would be you and your spouse. The charities named in the trust may either receive the balance of assets in the CRT at the end of its term, or may receive current income. (See discussion, below, on the two types of CRTs).

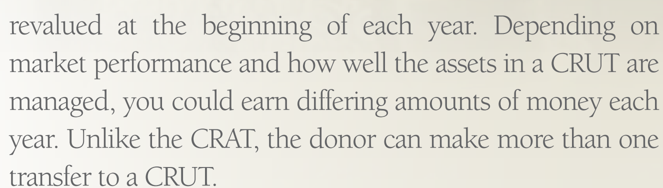
As the grantor, you would generally receive income from the trust during your lifetime or for a fixed term of years. If you are married and either you or your spouse dies, the surviving spouse will continue to receive income from the trust. You can add other beneficiaries to the trust and provide an income stream for them.

Even though a CRT is an irrevocable trust, you and your spouse retain the power to change the charitable beneficiaries at any time. Under certain conditions, you may even serve as trustees of the CRT. As trustees, you can maintain full investment control of the assets inside the CRT.

There are two types of CRTs—Remainder Trusts and Leads Trusts. In a nutshell, here is how they work:

A *Charitable Remainder Annuity Trust (CRAT)* pays the donor a fixed percentage of the value of the donated assets at the time those assets are placed in the trust. This means the income stream is level over the life of the trust. For example, a donor creating a 20-year CRAT worth $200,000 would receive an annual income of $10,000, assuming a minimum required yearly payout of 5 percent. Upon the death of the last living individual beneficiary or at the end of the specified term, the balance of the trust assets must be distributed to one or more charitable organizations. Also, the donor can only make one initial transfer of property to the CRAT. Additions to the trust in later years are not permitted.

A *Charitable Remainder Unitrust (CRUT)* also requires a fixed annual payout ratio of at least 5 percent. But, unlike the CRAT, the actual dollar amount paid out each year will fluctuate, because the assets held in a CRUT are



revalued at the beginning of each year. Depending on market performance and how well the assets in a CRUT are managed, you could earn differing amounts of money each year. Unlike the CRAT, the donor can make more than one transfer to a CRUT.

Charitable Lead Trusts

The second major type of CRTs are the ***charitable lead trusts (CLTs)***, where the donor makes a charitable contribution of trust income to a qualified charity during the trust term. In other words, the charity doesn't wait to receive trust assets upon the donor's death or at the end of the term. The purpose of a CLT is to reduce the donor's current taxable income. This works when a portion of the trust's income is first donated to a charity, and after a certain period of time (usually until all taxes are reduced), it transfers the remainder of the trust assets to family members or other non-charitable beneficiaries. This will reduce gift and estate taxes for beneficiaries.

If you're considering establishing any type of charitable trust, you can often go to the charity of your choice for assistance in setting up the trust. You should also consult your financial professional to determine how a charitable trust could fit in your estate plan. Your philanthropic planning could provide a generous benefit to your favorite charity while strengthening your legacy through tax savings.

Planning for Incapacity

Incapacity describes a medical or psychological condition in which you are legally unable to make your own decisions. When creating an estate plan, it's very important to establish clear instructions on how you would like your wishes carried out if you were to become incapacitated. Proper planning for incapacity takes into consideration the unexpected that might occur and creates instructions regarding medical care, personal business transactions, and naming the people you trust to make decisions on your behalf.

A person's incapacitation may occur without warning—by accident or sudden illness. If decisions and instructions have not been made ahead of time, doctors will have to make the best medical decisions they can without knowing a person's wishes and preferences for care. Furthermore, without a solid plan in place, a court would have to appoint a guardian to sign legal documents and handle the person's property and business matters. Creating a ***living will*** and a ***durable power of attorney*** can help to avoid these situations.

Living Wills

A ***living will*** (also known as an advanced healthcare directive or directive to physicians) is a document that expresses a person's desires and preferences about medical treatment in an end of life situation. Often this is a time when he or she has become terminally ill or permanently unconscious. While living wills are allowed in all states, certain formalities may apply in order for them to be effective. If valid, a living will binds health care providers to its instructions. Because medical issues surrounding end of life choices can be complicated, you may want to consult a doctor now to make decisions about treatment types and options before you reach a point in life when you may be unable to make decisions for yourself.

Durable Power of Attorney

A *durable power of attorney* can perform some of the functions of a living will, but typically this document does not govern medical or health care issues. Instead, it ordinarily is a document that authorizes one or more persons to act on your behalf on financial, legal and administrative matters, especially if you are incapacitated (not competent to make these decisions for yourself). If the durable power of attorney includes provisions related to your medical treatment and health care, it is generally used whenever the individual granting the power cannot make his or her own health care decisions; and it does not depend on terminal illness or permanent unconsciousness to become effective.

Planning for your incapacitation may be an uncomfortable subject, as it is for most people. But clearly documenting your wishes will help ease your family's confusion and anxiety if that event were to occur. Strengthening your legacy is more than preparing for the transfer of your assets. It involves making the proper arrangements to minimize stress and heartache for your loved ones during troubling times.

Understanding Estate Taxes

The goal of your estate plan will likely be to ensure financial security for your family. Without proper planning, estate, gift and generation-skipping transfer taxes (GSTT) can quickly erode the legacy you have worked so hard to build. Estate and gift taxes are part of a transfer tax system that is separate from the income tax system. Gift taxes apply to certain transfers of assets or interests in property that one person makes to another while still alive. Estate taxes come into play after a person's death.

Although current law repeals the federal estate tax and the GST tax in 2010, the law's sunset provision will end the repeal in 2011. Unless new legislation is enacted, the law will then revert to the rules that applied prior to passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

For persons dying after 2010, your estate is not subject to estate tax at the federal level until the value of the taxable estate passing on to others exceeds $1 million. You may think that this means you don't have to worry about estate tax diminishing what you will leave your loved ones—but not so fast. Before you dismiss the federal estate tax, be aware there are some types of property you may not consider part of your estate, but the government does. A common example is life insurance. What is the death benefit on your life insurance policy? Add this amount to your total assets. Other assets that are often overlooked are pension and retirement plan funds and the value of sizeable gifts you may have made over time. After you add all of these items up and then subtract the allowable deductions from your estate (e.g., expenses of your final illness and administration of your estate, and debts), if your net taxable estate exceeds the applicable exemption ($1 million in 2011), **your estate is subject to estate tax at rates that may approach 55%.**

Your Gross Estate

To calculate your gross estate, you need to determine the value of all of your property. The following is a listing of property that could make up your gross estate:

- *Personal possessions*
- *Amounts in your checking and savings accounts*
- *Stocks, bonds and other securities*
- *Real estate*
- *Partnership and business interests*
- *The value of life insurance policies' proceeds you own*
- *Debts owed to you*
- *Your interest in retirement plans and individual retirement accounts*
- *The value of any annuities you own*
- *The value of jointly held property*

Possible State Death Taxes

A new concern for estate tax planning these days is the possibility that your estate will be subject to ***state death taxes*** (estate and/or inheritance taxes imposed at the state level). There are 13 states, including the District of Columbia, that impose their own separate estate tax, which may be in addition to the federal taxes owed. There is a wide variety of state death tax systems, with differing exemption amounts and tax rates. Some states impose both an estate tax and an inheritance tax. Even if your estate is not subject to any Federal estate taxes, your estate (and heirs) may be subject to one or more of the state death taxes. Due to the complexity of these state tax laws, proper estate planning should involve a competent tax professional familiar with the estate tax laws in the state where you reside, and where any assets you own may be located.

Next Steps for Strengthening your Legacy

In order to start building an estate plan that fits your needs and strengthens the legacy you leave for your loved ones, contact your financial professional. Once you've established a solution for your unique situation, it's important to continually monitor your plan with your financial professional over time. Life changes, significant events and tax laws can affect the strength of the legacy you are so diligently building for your loved ones. Talk to your financial professional about the flexibility of your plan to make sure you can make adjustments as you encounter changes and events throughout your life.

These materials contain statements regarding the tax treatment of certain financial assets and transactions. These statements represent only our current understanding of the law in general and are not to be considered legal or tax advice by purchasers. Estate tax rules and the tax treatment of life insurance are subject to change at any time. Neither West Coast Life, nor its representatives offer legal or tax advice. Purchasers should consult with their legal and tax adviser regarding their individual situations before making any tax related decisions.

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