

Strategy Corner

Estate Planning: It's Not Just About Death Taxes

Benjamin Franklin once said “In this world nothing can be said to be certain, except death and taxes.” While death is certain, death taxes may not be. Thresholds have risen to \$3,500,000, so for most people, even those who are very well off, estate taxes should be of diminishing concern.

So if death taxes are not certain, why are the tax aspects of estate planning emphasized more than its true purpose – making sure that what you have gets where you want it to go in the best way possible while striving for as much family harmony as possible?

The reason that many planning professionals focus on taxes is because they were trained back when many more estates were taxed by the IRS.

The proof is in the statistics. In 1995, a tax return was required for any estate worth more than \$600,000, and 69,755 estate tax returns were filed nationwide. Out of those 69,755 returns, estate taxes were paid on 31,563.

Contrast that with 2007, when a tax return was not required unless an estate was worth more than \$2,000,000. Only 38,031 estate tax returns were filed, and estate taxes were paid on 17,416. As you can see, there was a large drop in the number of individuals for whom estate tax was an issue.

To add further perspective, 2,426,264 Americans died in 2006. (Estate taxes should be paid within nine months of death, so for purposes of this illustration all 2007 estate tax returns are being treated as if the person died in 2006.) Of those, only 17,416 individuals owed estate tax. This means that estate tax affected fewer than 1% of those who died in 2006. Simply by raising the estate tax exemption, fewer and fewer of us are subject to this tax.

For 2009, an individual has to have a net worth of more than \$3,500,000 before the estate tax applies. As of this writing, multiple bills have been introduced in Congress to address the future of the estate tax. All of the bills would set the estate tax exemption at \$3,500,000 or more. President Obama has indicated that he will support an exemption at this level.

So, because very few of us will be subject to estate tax, it should not be the main discussion topic of estate planners. For those of you who *will* have an issue with estate taxes, rest assured that in nearly every case, we can help you minimize your tax exposure and in many cases, we can help you eliminate your estate tax exposure.

But for everyone, the point of estate planning is making sure that what you have gets where you want it to go in the best way possible while striving for family harmony.

A Story

In order to better illustrate the art of estate planning let's work with a story:

Many years ago Mrs. B and her husband went to see an attorney to update their “estate papers,” as they called them. The attorney drafted simple wills and a revocable trust for

them. They lived modestly and owned a small business. Together, they had five daughters. Over the years, they bought some rental properties as part of their retirement plan.

Mr. B died first and his will left everything to Mrs. B. Mrs. B survived for another 20 years. Just before she died, she attended a “free” seminar that she saw advertised in the local newspaper and had this new attorney revise her estate plan. The new attorney was technically smart in terms of the estate tax, but he was inexperienced and inadvertently added some fuel to the family fire.

Mrs. B’s five daughters understood that an estate tax would need to be paid and were initially okay with selling the properties and splitting up the proceeds. What caused an all-consuming forest fire to break out in the family, however, was that there was no provision for how Mrs. B’s personal property was to be split among the daughters. The trigger asset was Mrs. B’s mother’s china set, which had a nominal economic value.

The executor attempted to settle this dispute by splitting it up among the children, by the setting. The daughters rejected this and 60 years of grievances were laid open, including the damaged bicycle of a five-year-old, multiple broken toys and stolen teenage boyfriends. All agreements about the sale of the real property fell apart and the litigation began. The children of the daughters, who were all close, were drawn into the squabble and two of these cousins who jointly own a business were fighting.

It would have been so simple to have had a family discussion about the disposition of her personal assets while Mrs. B was still alive, to consider every asset from those that were very valuable to those with little monetary value but great emotional value.

Distributing Personal Property

As illustrated in the story, the distribution of personal property, including mementos, is usually best not left to the discretion of your executor or heirs after your death. If you don’t want to have a family discussion, one solution is to prepare a personal property memorandum that itemizes personal property and names family members, other individuals, or institutions that are to receive them. Although this memorandum would not create a legal obligation because it is not part of your will or trust, it does express intent. Because it can be difficult for some people to directly communicate to heirs their wishes regarding the transfer of keepsakes, a memorandum may eliminate disputes about intent.

If you suspect that acrimonious squabbling over personal property is likely, you should consider incorporating a memorandum of personal property into your will or trust, as appropriate.

In some families, a “draft” of items is held where each family member takes turns selecting items that will pass to them. Many who employ this approach are surprised at who wants what.

Beyond Assets – Values

Many people that we speak with would like their heirs to accept and embrace their values. One practical step is to codify them in a clear way. You can accomplish this through what many planners call an “ethical will.” There is no prescribed content to an ethical will, but some topics you might consider include:

- Important family traditions

- Meaningful family or religious ceremonies
- Things that the author learned from older and younger family members and others
- Values that the author wishes to pass on to the next generation
- Meaningful changes in the world that have occurred over the author's lifetime
- Major changes that have occurred in the author's personal circumstances
- The author's important decisions that made a difference
- What the author might have done differently
- What the author hopes people will remember about him or her
- The author's feelings that he or she might not have shared with others
- What the author had hoped to accomplish but did not
- The author's favorite book or movie
- The author's hopes for the future

You may want to specify who should and should not read the ethical will and may choose to prepare different versions for different family members.

Conclusions

Yes, the world of estate planning is bigger than fights about china sets. But if you're not clear about your intentions, those fights may be unavoidable.

You may struggle to understand why your attorney wants you to have a will, a revocable trust, powers of attorney for healthcare, general powers of attorney, and additional special-purpose trusts, or to use limited liability companies or other vehicles to own and then transfer your assets. We can help you design your estate plan and make sure that you understand what these tools do for you.

If you would like to have a better understanding of your estate plan or would like to create one, please contact your Contango advisor.

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