STONEHEARTH
CAPITAL MANAGEMENT

ESTATE PLANNING

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AREAS TO EXPLORE WHEN PUTTING TOGETHER AN ESTATE PLAN

As investment executives who specialize in helping our clients meet their financial goals, we understand that you may have questions about the areas you need to focus on during this phase in your life. This special report presents a list of the areas that need to be explored when putting together an estate plan.

WWW.STONEHEARTHCAPITAL.COM
199 ROSEWOOD DRIVE, SUITE 200 • DANVERS, MA 01923 • {978} 624-3000

ESTATE PLANNING

Estate planning is the process of putting together the instruments necessary for the management and distribution of a person's estate during their life and after death. Everyone has an estate plan, whether you know it or not. The government feels that having an estate plan is important enough to institute a "default" plan of action if a person has not created a plan of their own. This means the government decides who inherits the assets, takes guardianship for minor children, and who is appointed as the personal representative to handle the estate. Most people do not want to rely on the government's default plan and instead decide to create an estate plan of their own.

Let's review some of the areas that need to be explored when putting together an estate plan.

1. COMPOSITION OF AN ESTATE PLAN

PLANNING FOR INCAPACITATION:

- **Durable power of attorney for health care**: This document identifies someone who will be authorized to make health care decisions for the person who created the document in the event they become incapacitated.
- **Living will**: This document lets people state their wishes for end-of-life care.
- **Durable power of attorney for finances**: This document identifies someone who will be authorized to make financial decisions for the person who created the document in the event they become incapacitated.
- **Trusts**: Most trust documents include language identifying successor trustees to take over the management of the trust if the current trustee becomes incapacitated.

PLANNING FOR DEATH:

- **Will**: A will directs how a person's assets are to be distributed and how debts, taxes and expenses are to be paid after someone passes away. Most wills include:
  - **Personal Representative**: The person who is charged with handling the decedent's estate.
  - **Guardianship:** The person who will provide care for minor children or incapacitated adults.
  - **Beneficiaries:** Identifies the individuals or charities that will receive some or all of the decedent's assets.
  - **Trusts:** Identifies whether or not trusts should be created and managed for loved ones.

- **Trusts:** A trust is a document that creates a financial arrangement to have someone (a trustee) manage assets on behalf of a beneficiary. To learn more about trusts, please click here for our paper on the "ABC's of Trusts."

- **Titling of assets:** How assets are titled can have a profound impact on the distribution of those assets after someone passes away. If assets are owned jointly with rights of survivorship, any surviving joint owner will take immediate ownership of the assets after one of the joint owner's passes away. However, if assets are owned individually without a beneficiary listed then that asset will need to flow through the decedent's will to identify how the asset should be distributed.

- **Beneficiary designations:** Beneficiary designations supersede the will, so it is very important to maintain updated beneficiary designations that match your wishes. It is also suggested that people consider naming both primary and contingent beneficiaries.

- **Life Insurance:** Life insurance can be an important piece of a comprehensive estate plan. It provides resources for loved ones to help with living expenses. Life insurance is also commonly used for family's that know their estate will be charged estate taxes providing them with the necessary funds to cover this expense.

2. IMPORTANT LIFE STAGES

From birth until age 18, a child's parents have the authority to make all legal and medical decisions on behalf of the child. So up until the age of 18, there is very little that can, or should, be done from an estate planning point of view.

Most states use age 18 as a demarcation of when a child enters adulthood. When this happens, a child's parents no longer automatically maintain the authority to make legal and medical decisions for them[1]. As a result, it is important for someone turning 18 to consider naming someone they trust to help make legal and medical decisions on their behalf if they are unable to. The primary documents that should be considered at this age are the durable power of attorney for health care, the living will, and the durable power of attorney for finances.

Most states allow someone who has reached the age of 18 to create a will that will dictate how their assets should be distributed in the event they pass away. Most young adults have limited resources, so the need for a will is not as great but remember that it is still an option if/when appropriate (i.e. inheritance, windfall, etc.).

The next likely milestone is marriage. When someone gets married, it might be appropriate to update the durable power of attorney for health care, the living will, and durable power of attorney for finances to give the new spouse the authority to make legal and medical decisions on behalf of the incapacitated spouse. "Sweetheart" wills are typically used which simply leaves everything, and anything, to the surviving spouse in the event that one spouse passes away.

When children enter the picture, the "Sweetheart" wills need to be updated to identify a guardian to care for the child. If a guardian is <u>NOT</u> identified, then the local courts will appoint one. For most families, this provides enough incentive to obtain a will so they can identify a guardian. Another important consideration is to determine when a child have access to their inheritance. Most states give this control to the guardian while the child is under 18. Most states turn this control over to the children when they turn 18. Most families feel that this is too much responsibility for an 18 year old to handle and opt to delay control to a later age. This can be accomplished by including provisions within the will directing the inheritance into a custodial account or a trust. A custodial account will delay control until the child reaches age 21 (in most states). A trust does not have a default age and can be customized. One example would be to give the child access to one-third of the inheritance at age 25, one-half at age 30 and the balance at age 35. In both the custodial and the trust arrangements, someone (custodian/trustee) is identified in the will who will manage the inheritance until the child reaches a particular age.

Retirement is an ideal time to dust off the estate planning binder. Review each of the estate planning documents to ensure that the named individuals within each are still appropriate and match desired outcomes. This might also be a good time to explore whether or not trusts would be a good addition to the estate plan, especially if your estate is large.

After a spouse passes away is another reason to review the family's estate plan. Most estate plans are written in such a way so that updating the plan after one spouse passes away is not necessary. That being said, it is still a good idea to review the documents and potentially move any secondary roles to primary roles if the decedent was listed as primary.

Finally, it is important to review estate planning documents after a divorce. All too often, these documents go unchanged and the ex-spouse ends up inheriting some assets. Take the time to review the documents and make any necessary adjustments as soon as possible.

3. TO PROBATE OR NOT-TO-PROBATE

Given the choice to "probate or not-to-probate," most would choose the latter. Probate is a public process involving the court systems to help distribute a decedent's estate. The key to avoiding probate is to eliminate the need to rely upon the decedent's will when distributing assets. There are three primary ways to avoid probate. Let's review them.

The first is with the use of a trust. Trusts can add a bit of complexity, however, they give the decedent more flexibility in managing and distributing assets "from the grave." Beneficiaries are typically identified within the trust document which eliminates the need to review the decedent's will, thereby avoiding probate. Trusts also have the added benefit of being discreet which appeals to those who want to keep their financial information private.

The second way that assets can pass on to someone else while avoiding probate is through joint ownership. If a bank account is owned jointly with another individual, that account will automatically pass to the surviving joint owner provided it was titled "joint with rights of survivorship," sometimes referred to as "JTWROS." If the joint ownership is titled "tenants in common" or "TIC," then the decedent's share will be transferred according to the terms of their will (a.k.a. probate).

The final way to distribute assets while avoiding probate is through the use of beneficiary designations. Naming a beneficiary on a particular account prevents the asset from having to flow through the decedent's will and the probate process. A beneficiary designation supersedes the decedent's will. Beneficiary designations can be listed on most non-real estate assets (i.e. life insurance, annuities, retirement accounts, brokerage accounts and bank accounts). To name beneficiaries on real estate families should consider a trust.

4. ESTATE TAXES

Estate taxes, otherwise known as “death taxes” or “inheritance taxes,” are owed by estates that exceed certain thresholds. In 2017, if a decedent’s estate passes to a non-spouse beneficiary and exceeds $5.49MM then estate taxes will be owed[2]. Spouses are entitled to a 100% marital deduction and as a result, decedent’s can pass on an infinite amount of money to a surviving spouse without triggering estate taxes, but the day of reckoning cannot be delayed forever. When the surviving spouse passes their own assets as well as the assets they inherited from their spouse, they will be subject to estate taxes with the exception of the $5.49MM exemption. In this situation, we lost the ability for the first spouse to pass away to utilize their exemption of $5.49MM. With a federal estate tax rate as high as 40%, this is an area that needs to be discussed and planned for in advance.

A traditional estate planning strategy for wealthy families is to have the decedent’s estate fund an irrevocable trust with an amount up to the federal exemption of $5.49MM. This ensures that the decedent gets to use their exemption. When the surviving spouse passes away, they too will be entitled to their federal exemption amount, meaning that we utilized both spouses’ federal estate tax exemptions. This has been a popular strategy for wealthy families.

A few years ago, Congress passed the portability rule giving surviving spouses the option to file an estate form to preserve any of the federal estate tax exemption that was not used by the decedent[3]. In essence, this has negated the need for irrevocable trusts since surviving spouses can still double the exemption through the new portability rule if they pay attention to filing requirements. Before families start eliminating irrevocable trusts from their estate plan, it is important to review the different options with a competent estate planning attorney who understands all of the pros and cons of each decision. Here in Massachusetts we have a state estate tax, and only the first $1MM is exempt. Portability is a federal rule and currently does not apply at the state level, so irrevocable trusts may still be necessary for those families that live in a state that charges estate taxes who have more than the exempt amount.

Financial planners and estate attorneys can review strategies to help reduce estate tax exposure. Most strategies include some form of gifting assets or giving up control of assets to help reduce the size of the decedent’s estate that would be subject to estate taxes. Annual gifts to people ($14K per person in 2017), funding 529 college savings plans, and moving money to irrevocable trusts, make up only a few of the available strategies. These are not “one size fits all” strategies, but instead need to be considered in the context of your goals, asset levels, and comfort level with the complexity of certain strategies.

5. ATTORNEY OR DO-IT-YOURSELF

Estate attorneys specialize in the area of estate planning. They are an obvious choice for a family looking to put together an estate plan. Other resources available are online do-it-yourself tools to create estate planning documents. An online tool that I have used in the past is Will Maker, available for download at www.nolo.com. If the family’s situation is rather simple and the value of their estate is below estate tax exemption amounts, then the online tools may suffice if they are comfortable using the computer. If the family’s situation is more complex and/or the value of their estate exceeds estate tax exemption amounts, than I think it warrants hiring an attorney. It is a personal decision based on your budget and comfort level.

6. REVIEW FREQUENCY

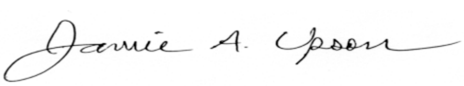
I would suggest that at a minimum, families review their estate planning documents every five to 10 years, or whenever you reach an important life stage (marriage, divorce, retirement, etc.). As we age, we may want to increase the frequency of reviews to every three to five years, since families are more inclined to rely on their estate planning documents as they get older.

SUMMARY

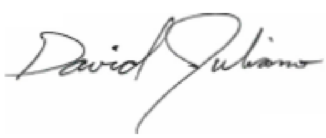
We hope that you found this whitepaper on Estate Planning to be helpful and informative. Please remember that nothing referenced in this paper should be construed as legal or accounting advice. Legal or accounting advice should only come from a qualified attorney or accountant.

If you would like to discuss your personal financial situation, please do not hesitate to give our office a call at (978) 624-3000. We would be happy to talk to you.

Sincerely,



Jamie A. Upson, CFP®, CMFC, AAMS
President & CEO
Jamie@stonehearthcapital.com



David Juliano CLU, ChFC, RICP
Senior Financial Advisor
David@stonehearthcapital.com

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[1] From the 'Lectric Law Library's StacksWhat Are the Requirements for Making A Will? (n.d.). Retrieved October 19, 2017, from http://www.lectlaw.com/filesh/qfl06.htm
[2] Ebeling, A. (2017, September 15). IRS Announces 2017 Estate And Gift Tax Limits: The $11 Million Tax Break. Retrieved October 19, 2017, from https://www.forbes.com/sites/ashleaebeling/2016/10/25/irs-announces-2017-estate-and-gift-tax-limits-the-11-million-tax-break/#63f037023b70
[3] Garber, J. (n.d.). Do You Understand Portability of the Estate Tax Exemption? Retrieved October 19, 2017, from https://www.thebalance.com/what-is-portability-of-the-estate-tax-exemption-3505672