



# Essentials of Estate Planning

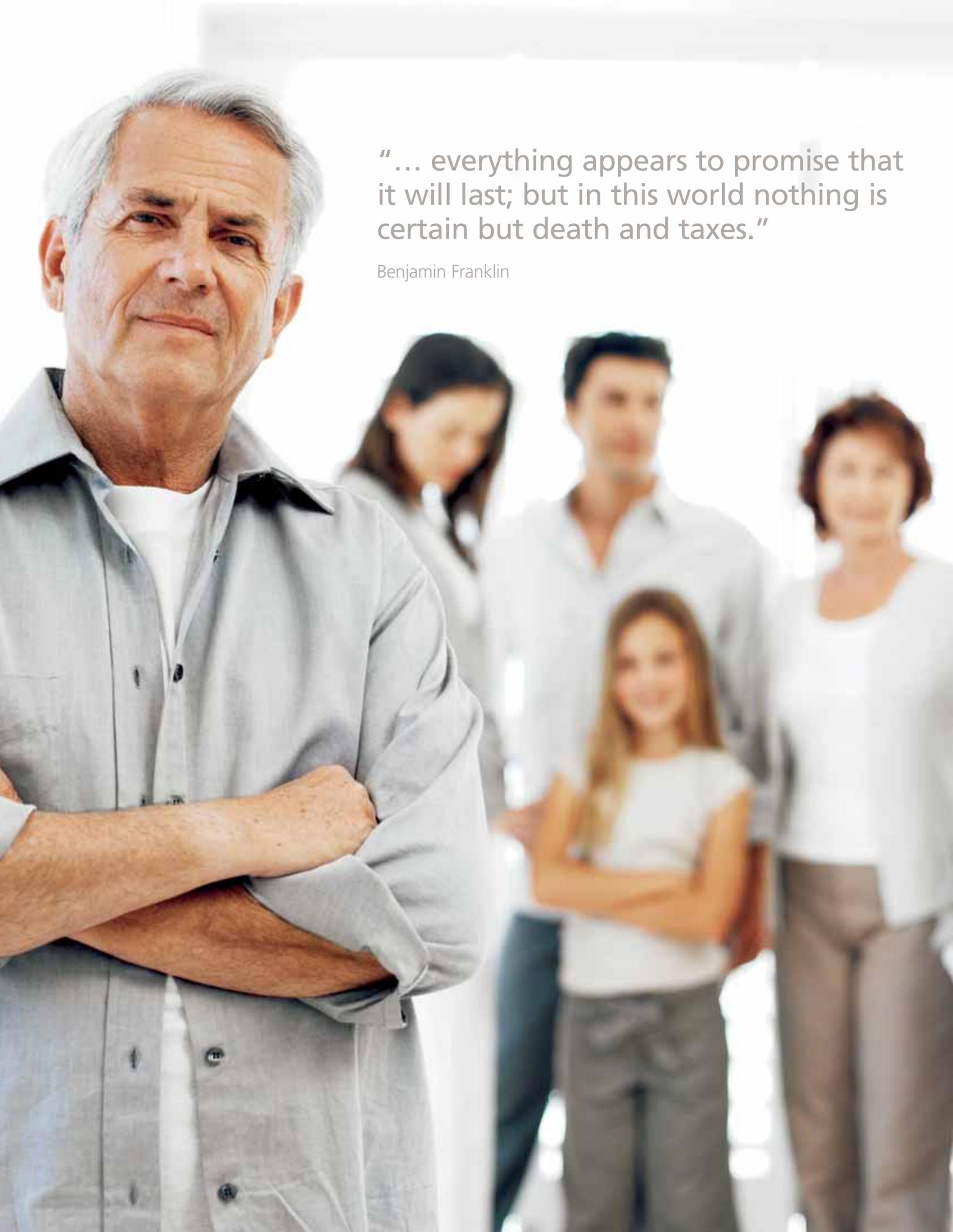
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"... everything appears to promise that it will last; but in this world nothing is certain but death and taxes."

Benjamin Franklin

As a wise man, Benjamin Franklin recognized two inescapable facts of life. If he were alive today, he would probably conclude that death and taxes are as certain in today's world as they were in his. He wrote in his book *Poor Richard's Almanac* that "an ounce of prevention is worth a pound of cure." In dealing with death and taxes, he might tell us that time and money spent on estate planning could be worth their weight in gold.

## What is Estate Planning?

Estate planning is an important part of financial life. It is the process of intentionally transferring the assets we've built during our lifetimes to those we love at our deaths with the least amount of loss and delay. Simply put, estate planning is the art of:

- distributing the right things
- to the right people
- at the right time
- for the right cost, and
- with the right assistance.

Unfortunately many people seem to find it difficult to do their estate planning. Sadly, many people spend more time planning their vacations than they do planning their estates. They look at estate planning as a burden instead of an opportunity. They let irrational fears and procrastination keep them from helping their families by preserving what they've spent their lifetimes building.

## Estate Planning Is an Act of Love

Estate planning isn't something we do for ourselves; we do it for those we care about. When you get right down to it, it's an expression of love. It is also a responsibility. Adults clean up after themselves; they don't pass the problems they create on to others and expect them to solve them. In estate planning we use our own time and energy so that our assets can be efficiently transferred to the people we care most about. If you are someone who is procrastinating on estate planning, here's a question for you to think about:

*"Do you love your family enough to spend some of your own time and money to potentially save them thousands of dollars in costs & taxes and countless hours of work?"*

We all want to help our families as much as possible. It's part of our responsibility of being a parent and grandparent. What is sometimes surprising about estate planning is that while we do it to help our families, we often wind up helping ourselves.

An effective estate plan transfers:

- the right assets to
- the right people at
- the right time at
- the right cost with
- the right management

## What Can Estate Planning Do For You?

What do you get when you do your estate planning and keep it up to date? You may not have spent much time thinking about it, but implementing an estate plan can give you at least two benefits: Control and Peace of Mind.

**Control** – Most people don't realize that even if they haven't done any planning, they still have an estate plan; they have the "government's plan." Our state legislatures have decided that estate planning is too important to be left undone. Each of the 50 states has adopted its own group of laws that dictate what is to happen to the assets of residents who die without a plan of their own.

The "government's plan" in your state is usually a "one size fits all" plan that wasn't designed with you or your family in mind. It wasn't written to fit your circumstances or to achieve your goals. It's a generic plan for everybody. When you create your own plan, you take back control so you can be sure the right things go to the right people, at the right time, at the right cost and with the right management.

**Peace of Mind** – When you are done with your planning, you will probably feel pretty good. It's easy for family members to fight over who should get what from a parent's estate. Longstanding sibling rivalries and distrust often come to the surface when a parent's estate is to be distributed. No one wants his/her death to create family animosity or trigger a family feud. You can design your estate plan to bring your family closer together instead of pushing it apart. When you've completed your estate planning, you know you will have done what you can to:

- Protect the financial security of your spouse/partner
- Promote good relationships between surviving family members
- Preserve family assets by reducing expenses and taxes
- Provide younger family members a good example for their own estate planning
- Show your family that you loved them.

# A Will Is Only Part of an Estate Plan

Many people think that once they've signed their wills, their estate planning is done. That would be a mistake. There's usually more to estate planning than just drawing up a will. For most people a will only transfers some of their property—the assets they own by themselves at the time of death. Other assets may not be affected by their wills at all. Assets can be transferred in a variety of other ways:

**Community Property Statutes.** Some states have adopted laws that treat the assets married couples acquire during the course of marriage as belonging to each of them equally, regardless of whose efforts produced the asset.

**Joint Tenancy.** This can occur when two people agree to own property (e.g. a home or a bank account) with a right of survivorship. If there are two joint tenants, each owns half of the property, but at the first joint tenant's death, title to the property automatically passes to the surviving joint tenant regardless of the terms of a will or other estate planning documents.

**Beneficiary Designations.** Many financial account balances are designed to be passed on outside of a will or trust agreement. The assets or account balances in qualified retirement plans, annuities and life insurance policies, for example, are transferred to the named beneficiary at the owner's or insured's death.

**Contractual Agreements.** A property owner can make an agreement with someone else to transfer specific assets at the owner's death. Such agreements are common. Examples include pre-nuptial agreements, buy-sell agreements, and the many different kinds of trusts.



# The Best Estate Plan Is a Coordinated Plan

How a particular asset will be distributed at death depends on a variety of factors. That's because we acquire our assets one at a time over many years. Each time we acquire a new asset, we don't usually stop to think how it should be owned to best fit into our estate plans. For example, when you open an IRA account, you focus on how it's going to help you afford to retire, not who should take it over in the event of your death. Consequently, most of us have unconsciously developed a "patchwork" estate plan that uses a variety of distribution options. Our homes may be owned in joint tenancy with our spouses. Our IRAs are contractual agreements distributed according to the beneficiary designation and our stock investments are personal assets that are distributed under the terms of our wills.

A good estate plan considers the different assets we own and coordinates how they are distributed so our overall wealth transfer goals can be accomplished. It matches each asset we have with the options for passing it on. It manages the assets in an *integrated strategy* to deliver the right assets to the right people, at the right time, for the right cost and with the right amount of management assistance if any is needed. You should consult with your legal advisors to see if your estate plan is integrated so that your assets will be delivered as you expect.



# Common Estate Planning Tools

We already mentioned wills, joint ownership, beneficiary designations and contracts. These are all widely used estate planning tools. In addition, there are several other commonly used estate planning tools that need to be kept in mind. They include:

**Powers of Attorney**—These are written documents that allow us to give someone else the authority to act on our behalf while we are alive. A financial power of attorney gives someone else the ability to handle our financial affairs. A healthcare power of attorney gives someone we trust the ability to make medical decisions for us if because of sickness or injury we lose the capacity to make them ourselves. The rules for powers of attorney vary from state to state. They are effective only while we are alive.

**Lifetime Gifts**—If we are legally competent, we don't have to wait until we die to transfer property; we can give away any of our assets while we are alive. People regularly make gifts to friends, family members and charitable organizations. Many people enjoy making gifts because it gives them the ability to see the benefits the gift can generate while they are living. There are a number of tax rules regarding gifts and many strategies have been developed over the years to use lifetime gifts as part of an integrated estate plan.

**Trusts**—Trusts are contractual agreements in which a person (a grantor) transfers money or assets to a third party (a trustee) who agrees to hold and manage the property for the benefit of others (the beneficiaries). The trustee preserves, manages and distributes the property according to the grantor's directions as they are written in the trust agreement. There are many different kinds of trusts and they can be established while the grantor is alive or after his/her death. They can be used to achieve gift or estate tax savings for the beneficiaries and if properly written, they may also be able to protect the property from beneficiaries' creditors. Trusts can be quite complex and should only be drafted or interpreted by a licensed attorney.

**Life Insurance**—This is a contract between an individual and a life insurance company for the payment of a death benefit at the time a designated insured dies. Life insurance is often used in estate liquidity planning because of its ability to pay the death benefit income tax free at a time when money is needed to pay estate settlement costs. These death benefits can be paid outside the probate process and, with proper planning, they can avoid federal estate taxes.

Moving assets to surviving family members when we die isn't free. In fact, sometimes it can be quite expensive. Personal representatives/executors may have a large variety of expenses and obligations to satisfy before the remaining property can actually be distributed.

## Transferring Assets Costs Money

A good estate plan projects what those costs are likely to be and then looks for ways to minimize them. Costs that are commonly incurred and should be planned for include:

- Funeral Expenses
- Medical/ Nursing Home Expenses
- Outstanding Debts
- Bequests in a Will
- Income Taxes
- Property Taxes
- Probate Court Fees
- Property Management Fees
- Federal Estate Taxes
- State Death Taxes

Potentially the largest of these costs is the federal estate tax. It is an excise tax on the right to transfer property at death. Transfers to a surviving spouse are estate tax free if they qualify for the marital deduction. But transfers to children, grandchildren and non-family members may trigger federal estate taxes when the amount transferred exceeds the available limits. Recently Congress has seen fit to change both the exemption from estate taxes and the estate tax rates on regular basis. It is probably a good idea for us to consult with our tax and legal advisors for insight on whether we are likely to be subject to the federal estate tax. From 2008 through 2013 the limits and rates established by Congress are:

Year	Estate Tax Exemption	Highest Estate Tax Rate
2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010	\$5,000,000	35%
2011	\$5,000,000	35%
2012	\$5,000,000	35%
2013	\$1,000,000*	55% + 5% surtax*

\*Because of the political nature of the federal estate tax, it is possible Congress may revise the exemption and/or maximum tax rate.

# Good Planning Includes a Liquidity Review

After asset transfer costs are identified, they can often be reduced. However, it is very difficult to eliminate these costs completely. In fact, the larger the value of the assets to be transferred, the greater the costs are likely to be. This is especially true when the estate is large enough to have a federal estate tax problem. A good estate plan includes a Liquidity Review. This is the process of estimating the amount of money that will be needed to pay the settlement costs and comparing them with the liquid assets the estate has available.

A Liquidity Review is important because many of us have the majority of our assets tied up in illiquid assets like real estate, closely owned businesses, privately traded securities or other assets that can't easily be converted into cash. When there isn't enough cash available to pay settlement costs, some of the illiquid assets must be sold. These sales trigger other costs and fees (i.e. real estate commissions and brokerage fees). If the timing of the sale is poor, there may not be any buyers willing to pay a fair price.

A Liquidity Review determines whether there is likely to be a shortage of liquid assets. If a shortage is likely, it considers the alternatives available for increasing the amount of liquid assets. It determines the best way to secure the extra cash needed and then follows through to make sure it is available. Here are two people who could have used a Liquidity Review:

## **Conrad Hilton** (owner of the Hilton Hotel chain)

Mr. Hilton's estate was valued at almost \$200 million. The cost of settling his estate exceeded \$105 million, most of which was federal estate taxes which had to be paid in cash. His heirs received only 47% of his fortune. Although that was still a substantial amount, imagine how difficult it must have been for Mr. Hilton's executor to sell enough assets to write a check to the IRS for over \$100 million.

## **Jessica Savitch** (NBC News Anchorwoman)

Ms. Savitch had an estate valued at \$2,175,463. After paying the settlement costs (over one third of which were federal estate taxes), her heirs ended up with less than half of her estate. A Liquidity Review might have increased what she could have passed on to her loved ones.

Although we may not have accumulated Conrad Hilton's vast fortune or even Jessica Savitch's smaller one, our families could still feel the pain of significant estate settlement costs. Federal estate taxes could pose a big problem for estates large enough to exceed the federal exemption limit. It may be wise to talk with your tax and legal advisors about whether your estate may be subject to federal estate taxes.

# Alternatives For Paying Settlement Costs

Estate settlement costs often have to be paid quickly, sometimes before remaining assets can be legally distributed. Because the amount of liquid assets available can have a big impact on surviving family members, it is important to know what the normal alternatives are for paying taxes and other settlement costs. If our Liquidity Review shows that we don't have enough cash currently, there are three potential ways our executors/personal representatives can make up the shortfall:

- 1. Sell Illiquid Assets**—This strategy has an element of risk because there must be a good market for the assets to be sold and the potential buyers must not know that the executor needs to complete the sale relatively quickly.
- 2. Borrow the Money**—This strategy is seldom efficient for several reasons:
  - interest must be paid on the outstanding loan
  - other assets will have to be pledged as collateral for repayment
  - illiquid assets must eventually be sold in order to pay off the loan.

Thus, the cost of borrowing to pay settlement costs will be more than the amount due.

- 3. Life Insurance Death Benefits**—This strategy may be useful when life insurance is purchased before death. If we are healthy enough to qualify for life insurance, the policy death benefits can operate like a cash infusion when we die. Depending upon age, health, and type of policy, a death benefit will usually be greater than the premiums paid in; as a result, the policy can be an excellent source of additional liquidity. However, to get the most out of our life insurance, we need to handle it carefully. We need to make sure the policy death benefits don't create or increase estate taxes. If our estates are already large enough to be subject to federal estate taxes, then it may make sense for someone else to own the policy. Options include our spouses, our children or an irrevocable life insurance trust (ILIT) established for their benefit.

Planning in advance for paying estate taxes and settlement costs can be important. Those obligations will have to be paid one way or another. If we don't set aside funds to pay them, the IRS and our creditors will seize our most valuable assets and force them to be sold to generate cash. A little bit of planning today about how to pay our taxes and settlement costs can save our spouses, children and grandchildren a lot of inconvenience and perhaps a lot of money.

## A Good Estate Plan Stays Flexible and Up To Date

Estate planning is not a “one and done” plan. We need to review our plans regularly because our families, our assets, our responsibilities, our objectives and the tax laws change over time. Change is one of the constants of life. We would be wise to review our estate plans at least every three to five years so they stay current with our families, our finances, our objectives and the law.

## Assemble an Estate Planning Team

Depending on our individual situations, creating an integrated estate plan can be simple or complex. It's usually a good idea to involve a variety of financial experts to provide advice. An experienced attorney can help draw up the needed legal documents, including wills, trusts and powers of attorney. A good accountant or CPA can provide invaluable tax advice. Investment professionals can help us manage our financial assets. Insurance professionals can evaluate our health, medical, property and life insurance coverages and analyze other policies currently available. A funeral director can be invaluable in deciding on final arrangements and minimizing funeral costs.

## Take Care of the Ones You Care About

Estate planning is a responsibility of adulthood and an act of love for the people we care most about. In a nutshell, it is the process of transferring the right assets to the right people, at the right time, with the right cost and with the right management. It protects the assets we've assembled over our lifetimes and the families we've built, loved and cared for. An estate plan creates a strategy to coordinate the orderly transfer of our property while setting aside enough liquid assets to pay off the debts, taxes and settlement costs that come with finalizing our financial affairs. A good plan can give us control over the future use of our assets and the peace of mind to know we've done everything we can for those we love.

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