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Web Event Transcript:
Demystify Your Estate Plan

CHAPTER 1

MR. YOUNG:

Hi, everyone. And welcome to T. Rowe Price's Demystify Your Estate Plan, A Straightforward Approach. This is our first in a series of two webcasts on the topic of estate planning. We're gonna cover some of the basics in the first one and some more advanced topics in the second. I'm Roger Young. I'm a CFP and a senior financial planner at T. Rowe Price. I'll be the moderator today, and I'm joined by Angela Vallario. She's a law professor at the University of Baltimore School of Law. And Stuart Ritter, who's another senior financial planner here at T. Rowe Price. So thanks for joining us.

We'll start with talking about what we hope to accomplish here today, some of the fundamentals of estate planning. So we'll talk about why estate planning is important. We'll talk about what happens to you and your family, if you don't have an estate plan, which would be unfortunate, and some of the basic documents that are considered part of an estate plan. So again, the basics. So maybe we'll start with what is the goal of estate planning. How would you describe the objective of an estate plan to someone that you're talking to on the topic?

MS. VALLARIO:

Well, generally when one wants to do an estate plan, their objective is to understand what's going to happen with their property upon their death. Who are the beneficiaries, when will they receive the property, will it be out right or in trust. Another thing that is accomplished in an estate plan is selecting fiduciaries, whether it be the executor or trustees or guardians. And the other thing is to make sure that you have a good understanding of what your family member's wishes and desires are.

MR. YOUNG:

Great. Stuart, what would you add from a financial planner's perspective?

MR. RITTER:

It is about making sure that what you want to happen -- happen to you and your kids, if you have minor children, and your stuff, your assets, is actually what occurs in the event that you can no longer tell us what you want that to be, and that is if you're incapacitated or when you pass away. And the estate plan outlines for the rest of us who are left behind exactly what you want to have happen to those things.

MR. YOUNG:

So we think about it in terms of what happens when you die, but it's also if you can't make those decisions for yourself.

MR. RITTER:

Absolutely.

MR. YOUNG:

Great. So when you think about estate planning, it's easy to get intimidated by a long list of documents that you might have to do. Angela, maybe you can help us to simplify that and think about, you know, what are the key considerations for the documents.

MS. VALLARIO:

Yeah. When someone gets their estate planning done, there are essentially about four documents that are options. Documents that control things while you're alive include the power of attorney as well as the advanced medical directive. So those two things are effective while you're alive and allow you to name an agent to make decisions for you if you are unable to, in the case of the advanced medical directive, or immediately in the case of the financial power of attorney. I think most of us really understand estate planning in terms of a will or a trust, so that is probably the number one document that's put in place to the extent that one gets their estate planning done.

MR. YOUNG:

Great. So why -- why don't we cover each of these in order. So we'll start with the ones that potentially can have an impact on you while you're alive. So the power of attorney. Angela, maybe you can give us a little bit more thought on what are the different types of powers of attorney and what do those entail.

MS. VALLARIO:

Yeah. The two types of powers of attorney include the general power of attorney, which is a blanket power, financial power given to an agent to step into the shoes of a principal during the principal's lifetime, and the second is a limited or special power of attorney which might be put in place, for -- for example, if you were going to be out of the country for a short period of time.

MR. YOUNG:

Great. So that's one of the distinctions, general versus limited. And then there's also some terminology in terms of what happens if you become incapacitated, right?

MS. VALLARIO:

Yes. Usually powers of attorney are what they call durable, and that means that it survives one's incapacity. It is the primary reason why people who are young and healthy put powers of attorney in place while they are young and healthy, so that it will survive one's incapacity. So those are typically automatically durable. However, if for whatever reason one does not want durability, you could draft around that durability provision.

MR. YOUNG:

And what if you want a power of attorney to take effect after you become incapacitated?

MS. VALLARIO:

Well, generally a power of attorney is effective immediately. However, if one chooses to have a power of attorney spring into existence upon incapacity, that too is a possibility. There is a little delay, however. If you decide to have a springing power of attorney, that springs into existence upon one's incapacity, a physician will have to attest to incapacity. So therefore there will be a little delay in its being effective and used in that fashion.

MR. YOUNG:

So generally most of the time you see a durable power of attorney.

MS. VALLARIO:

A durable power of attorney that's effective immediately is typically what is put in place by most clients at this point.

MR. YOUNG:

Now, that gives people a lot of power, right, or the agent that you're talking about who can act in -- on your behalf. Is that scary to people? Are -- are there factors to consider to limit your risk if you're giving a power of attorney?

MS. VALLARIO:

Well, first of all, remember that no agent can act without the document itself. So if you're concerned about an agent going down to the financial institution and making withdrawals, I consider you don't give them the physical power. Even if you do give them the physical power, an agent is a fiduciary. So they're in that role as a financial power of attorney -- agent using your property for your benefit. They can't just take the money for their own use. That would be a conversion and would be illegal. So they are held to a fiduciary capacity, but if you are concerned perhaps maybe about naming an adult child as a financial agent under a power of attorney, I suggest that you just don't physically give them the document at this point.

MR. YOUNG:

Right. And, Stuart, any -- any thoughts from your perspective on naming people as power of attorney?

MR. RITTER:

Yeah. Obviously it's gonna be someone that you've got a lot of confidence in and trust at a high level. So be thoughtful about who this person is, recognize the things that Angela has pointed out, and make sure that you've been very deliberate about who you choose to serve in this capacity.

MR. YOUNG:

So the key is who you choose.

MR. RITTER:

Absolutely.

MR. YOUNG:

Okay. Now, the second item on our list involved health care, and so you can have a health care power of attorney. You hear people talk about living wills and advanced directives. Can you help people understand how those inter-relate and -- and what we're talking about in the -- in the realm of health care?

MS. VALLARIO:

Yes. An advanced medical directive is a combination of a health care power of attorney where you name someone to make medical decisions on your behalf if you are unable to, and secondly makes your wishes known regarding life sustaining procedures, what was typically referred

to as a living will. So the advanced medical directive brings both of those documents into one.

MR. YOUNG:

Great. Good. I think that that helps to -- people to understand the terminology a little bit better.

Now, the third item was a will and possibly a trust. So now we're in the -- the discussion of what happens when you die. And maybe we'll start with a basic question of, you know, why you really need to have a will or a trust. You think about what happens if you don't have a will and then it's governed, my understanding, is by the states and state law. And the people who wrote those laws weren't trying to hurt people, right. So in what circumstances is it most important to have a will or should everyone have a will?

MS. VALLARIO:

Well, if you die without a will, the legislature in the respective state has dictated what is to happen with your probate property, and that's property in your sole name. They also dictate who your personal representative or executive is, and they are not going to have any management feature attached. And as you indicated, it's -- it's objective. So they look at what do most people want. So your specific intentions and wishes are ignored to the extent that you die without a will.

MR. YOUNG:

Stuart, anything to add?

MR. RITTER:

Yes. These rules that are in place are designed to be a one size fits all. And even if they're designed with the intent to, you know, do the best they can, you might have a different idea about whether your spouse should get all the money and your children get none or it's split somehow. So without a will in place, without an estate plan in place, you're losing the opportunity to personalize what happens to your particular situation and your beneficiary's particular situation. So stepping aside and just letting rules that are already in place take precedence over what you might wanna do means your -- you and your beneficiaries are subject to whatever those are instead of making sure it's taking care of what you want.

MR. YOUNG:

So it's all about making sure that your wishes are met, and I guess there are a lot of different types of things you can own and a lot of different ways that things can pass to other people. Maybe let's go into that a little bit. So considering that range of -- of actions that can direct your assets, what are some of the most important things to consider and the order in which those things happen?

MR. RITTER:

Yeah. The control of who gets your assets when you pass away is dictated by first who own it. So we call that title. So if you own an asset with somebody else jointly and they have right of survivorship, when you pass away, they get the asset. So the first thing we look at is does somebody else own the asset with you, and if so, they're the ones who get it. For assets that you don't own with somebody else, and there are lots of those, we look to see if you're designated a beneficiary or have filled out a transfer on death designation. So those would be things like a 401(k) plan or an IRA or a life insurance policy. In most cases you write down the name of somebody to be the beneficiary. When you pass away, we look to see who that is. They're the ones who get those assets. Then something that is owned only by you and doesn't have a beneficiary or a transfer on death designation, those are the ones that drop down to the point where they're controlled by your will. So those are the assets that then go through a probate process, and how you've written things in your will dictate who gets them. And those are a hierarchical order. So if you've got a beneficiary designation on an account, even if you write about that account in your will, the beneficiary designation takes precedence. Now, there is one other thing to bear in mind. There's another way you can own an asset, and that's through a trust. So you set up a separate legal entity and that entity will own the asset, and that's another way that ownership takes precedence, and whatever the trust says, that's how your asset will be passed along after your death.

MR. YOUNG:

Okay. Well, I think that hopefully clarifies things a lot for people. Let's talk about each of those three main boxes here in order. So first was ownership or the title to an asset. Can you give us some examples of different types of -- of titles?

MR. RITTER:

Sure. So I can own my car in only my name. I could own the house jointly with my wife. I could have a custodial account where my child, my minor child is owning it, but I'm the person that's taking care of the money and using it on their behalf. So those are ways things can be owned. Now, there again a couple of different situations where I'm the only owner of the account, like a 401(k) or an IRA, but I've got the beneficiary designation, and then there's the situation where I've written up a transfer on death on something like a bank account, a checking account or a savings account.

MR. YOUNG:

Great. So -- so that's the -- the title. And you mentioned in there that some of these types of title or ownership have beneficiary designations. My understanding is beneficiary designations are something that can easily be mis-understood or neglected, right?

MR. RITTER:

Yes.

MR. YOUNG:

So maybe talk through some of the examples of what can go wrong here.

MR. RITTER:

I read a statistic once that said a significant percentage of married people still have their mom listed as the beneficiary on their retirement account. And you could totally see why this would happen. You come out of school, you take your first job, you're filling out the forms, there's no significant other at that point, so you put mom down as your beneficiary. I'm not sure why dad never makes the list, but mom's down as the beneficiary. And then later on you get married. Well, if you don't go back and change the beneficiary on that account to your now spouse, if you pass away, that money goes to the beneficiary that's written down, and that's mom. So people will often forget that they've done that. Maybe they've got a couple of IRAs in different places and haven't paid attention to what those are. So recognize that whoever's name is written down as the beneficiary, even if you've addressed that issue in your will, that person who's listed will get the asset. So it's important on a regular basis to make sure you've gone back and thought through who should get it.

The other time it'll come up is marriages in divorces. So I've designated my spouse and then I get divorced and I get remarried. If my ex-spouse is

still listed as the beneficiary, they will get the money even though I've married somebody new.

MR. YOUNG:

So in your first example, as much as we love mom --

MR. RITTER:

-- absolutely.

MR. YOUNG:

-- we wanna make sure that that's really what we wanna have happen.

MR. RITTER:

Yes. Yes.

MR. YOUNG:

Okay. Good.

MR. RITTER:

Definitely.

MR. YOUNG:

So we've talked about the title and for joint -- jointly held assets, that's the first step. Then there's the beneficiary designation, and if neither of those applies, then it goes through the will. So maybe we can talk a little bit, Angela, about what is a will, what does a will need to have in it, how does a will work.

MS. VALLARIO:

Well, one thing that I think everyone should remember is that a will speaks at death. So you can put a will in place now, but it's not effective until your death, at which point it becomes effective. It controls only assets that are in your sole name. It gives you the opportunity to designate guardians, personal representatives, and trustee. And you had the ability to incorporate a trust in a will by testamentary trust. So if you want to manage property for the benefit of minors, you can do that in a will with a testamentary trust.

MR. YOUNG:

Great. Now, one of the things that I've heard come up a couple times now is the concept of probate. And so you hear about probate and wills going

together, and sometimes people talk about probate like it's a scary thing or it's a thing to be avoided. Angela, maybe you can set the record straight. Give us some understanding of the probate process and -- and when is it a good thing or not such a good thing.

MS. VALLARIO:

I actually think probate is a good thing. It offers a court supervised process for the transfer of assets from the decedent's sole name to the name of other beneficiaries. It allows for the appointment of a personal representative or executor who is the one that could stand in your shoes. So, for example, if you happen to own a car in your name and you passed away, a personal representative would be appointed through this process and with their letters of ministration would be able to go down to the Motor Vehicle Administration and have that car retitled either into the name of the estate or into the name of the respective beneficiary.

MR. YOUNG:

Good. So -- and make sure that there's a court looking over the process where things that aren't through probate don't have that benefit.

MS. VALLARIO:

That's correct.

MR. YOUNG:

Okay. So it's not a -- all a bad thing. It's a very public process though, right?

MS. VALLARIO:

It is a public process. Once you die and you have an executor appointed, your will becomes public record. So it is public as opposed to private.

MR. YOUNG:

So if you're famous, that might be why people are saying get things away from probate and into a trust, as an example.

MS. VALLARIO:

That's exactly correct.

MR. YOUNG:

Good. And we'll come back to trust in a -- in a little bit. But, Stuart, maybe you can help us, since you deal with a lot of people and their types

of accounts, maybe help us understand which types of assets are probate and which are not probate.

MR. RITTER:

Yeah, as Angela said, the ones that are going through probate are the ones that are in your name alone. So not something you own with somebody else, not something that you got the beneficiary designation or the transfer on death designation. So the things that are just in your name. And they go through the probate process whether you have a will or not. It's those things that you own by yourself that are gonna go through this court process.

MR. YOUNG:

Okay. Good. So we talked about the way of distributing assets through a will so that it's in accordance with your wishes. Maybe we'll talk a little bit about the softer side of estate planning, and -- and, Stuart, you can help us think about those goals of family harmony and having things done in accordance with your wishes and -- and those might or might not be in sync with each other. Help us think about how you prioritize those -- those two different aspects.

MR. RITTER:

Right. The -- the family harmony issue is important, as is the issue of you are giving things as you want to give them. So it's important to approach it as saying, okay, I'm gonna try to do this and that. And figuring out a way to make those happen. The other thing that's helpful to recognize is you've been making these kinds of decisions your whole life, especially if you have kids, you don't treat every one of your kids exactly the same all the time. So you've had some practice doing this. Be thoughtful about it. Think through who am I going to give certain things to. If something is more meaningful to one child than another, you might wanna give that to them and still keep in mind that maybe there is some sort of compensating thing I can give to the others. If you have a child living with you in the house, they may be expecting that after you pass away, they get to still live there. So thinking about whether or not you're going to accommodate that. And if there's certainly a family business and one of your children is working in the family business, thinking through how you'll accommodate that.

The other big aspect of it is communication. Making sure that after you've thought about these things, you're sharing with people what your

thoughts are, why you may have done one thing and not another, and at least have people understand some justifications, because it won't in most cases be everybody getting exactly the same thing.

MR. YOUNG:

Good. Well, that -- that helps us to put things into a little bit of perspective. Thank you. Now, when we talked about those three ways and the order in which your assets are distributed, we mentioned trusts as kind of a special case of a type of title. We'll go into trusts a little bit more in our second segment, but maybe for our purposes here, Angela, can you just talk a little bit about what a trust is and what that means to people, how they should think about that in the big picture?

MS. VALLARIO:

Yeah. A trust is a separated legal entity. A trustee, who is the fiduciary in charge of the assets owned by a trust, is the one that follows the trust terms. You can set up a trust, as I indicated earlier, in your will, or you can set it up separate from your will, known as an inter-vivos trust. You do that while you're alive. It's a document separate and apart from -- from your will, and if you create an inter-vivos trust, you could create it in a way that made it revocable, so you could bring back or change the terms at any point during your lifetime, and this is sometimes referred to as a living trust, or you could create an irrevocable trust where you've parted from the -- about to pull back the asset. And an irrevocable trust is often times used as a way of sophisticated gifting during lifetime.

MR. YOUNG:

Great. And we'll -- we'll come back to that a bit more in our second segment, but I appreciate the overview of -- of what trusts are.

Another topic that often comes up when you're thinking about estates is taxes. And everyone wants to save money on taxes. And again, we'll talk about that a bit more in the second segment, but, Stuart, should most people be super worried about taxes and estate taxes?

MR. RITTER:

No.

MR. YOUNG:

Very good.

MR. RITTER:

For most people -- for most people, their estate will not be subject to federal estate taxes. If the value of your estate when you pass away is under $11.18 million, federal estate taxes will not be applied to your estate. So for the vast majority of people, their estate will be under that amount. So federal estate taxes are not an issue. Now, there are some people that will have amounts above that, and that is something they should be thinking about. For the vast majority of folks, it's not something you really need to be worried about.

MR. YOUNG:

Good. Well, that hopefully puts a number of people at ease out in -- in the audience.

So we talked about the different types of documents, we've talked about the way that the law treats different types of assets and the order in which things are done after you die. We've talked about some of the bad consequences that can happen if you don't have a will or an estate plan. Let's leave it on a -- a happy note. What's a picture of a good estate plan and a good outcome for your family after you die? Angela, maybe you can start.

MS. VALLARIO:

Well, I think the advantages of putting an estate plan in place is, number one, you give some thought to who gets what, when, and under what conditions. You get to think about who is going to be the fiduciary in charge of the assets like a trust for the benefit of minor children. You also give -- get to think about naming guardians. You wouldn't want a court to have to appoint a guardian of your minor children. So this is the place where those types of decisions are put in place so that they take effect upon death.

MR. YOUNG:

So, Stuart, it sounds like it's largely about leaving people something orderly when you go. Is that -- is that the picture we wanna leave people?

MR. RITTER:

That is a big part of it, making sure that how you want things to happen is actually how they occur. I also like to take that picture and look at it from another side. Another positive aspect is the people in your lives who are expecting something or relying on you in terms of having assets after you

pass away are confident that things are going as you've communicated to them and they may be expecting. So it's everybody who's involved in the process feeling like it's been thoughtful, that things are going to happen in a way that was deliberate, understanding the reasoning behind it, and that puts people in a position where during what's otherwise a very difficult time, things are going the way that you wanted them to go and that people were expecting to go, and it helps a lot in those situations.

MR. YOUNG:

Great. Well, I've -- I've heard it said that this is your last lesson that you impart to your family. So it's -- it's nice to leave with a good, positive lesson.

So as we wrap up our -- our first session here, maybe we can talk about just a few practical points. What are a few, you know, specific things that people should think about that you wanted to emphasize for our audience?

MS. VALLARIO:

I would just add that people should be prepared, that sooner rather than later is always best. A will speaks at death, so you're not transferring anything to respective beneficiaries, but it forces you to sit down and go through the process. They can be amended at any point, but it's also important that your estate plan is flexible and grows with you. So if you put an estate plan in place now when you have minor children, there's no reason for you to have to update that if nothing else has changed except for those minor children are now adults. So my suggestion is be prepared sooner rather than later.

MR. YOUNG:

Good. So you can write a lot of the future consequences and changes into the document, you know, even if your kids are young. Good.

Stuart, what -- what would you like to add?

MR. RITTER:

Yeah. Building on that, recognize that putting an estate plan together to a large degree is a one time event. I think sometimes people are intimidated by doing it and feel like it's something they're gonna have to keep dealing with over and over again. And the reality is put some thought into it. Once you've put the plan in place, you might have to tweak it if there are

some family circumstances that change, but once you've got it there, you can be confident that you've expressed what you wanna have happen and that's what will occur.

MR. YOUNG:

Great. Well, thank you both, Angela, Stuart, I appreciate your -- your time and expertise on a topic that can be a little bit challenging for folks, thinking about how to -- to manage their estate plans. We hope you've enjoyed our first segment of Demystify Your Estate Plan. Hope you can join us for the second one if you have some situations that might require a little bit different -- different techniques than a basic will. Again, I'm Roger Young. I'm here with Angela Vallario and Stuart Ritter. Hope you enjoyed it. Please feel free to fill out our survey online. We'd love to hear what you did and didn't like or ideas about future webcasts. Hope to see you on the next one or on a future webcast on a different topic. Thanks so much.

CHAPTER TWO

MR. YOUNG:

Hi, everyone, and welcome to T. Rowe Price's Demystify Your Estate Plan, A Straightforward Approach. This is our second in a series of two webcasts. In the first episode we covered the basics of estate planning, and in this segment, we're going to go a little bit more into detail about some specialized situations that you might have. I'm Roger Young, a senior financial planner here at T. Rowe Price. I'll be the moderator and I'm here with Angela Vallario, who is a law professor as the University of Baltimore School of Law, and Stuart Ritter, who is another senior financial planner here at T. Rowe Price.

So for this second episode, we're gonna talk about some things going beyond the basics a little bit. So what are some of the family circumstances that need to be considered in your estate plan. And what are some advanced strategies that you can use to handle those situations. We'll talk a bit about what information your family needs to know, who's going to help you carry out your wishes, and how to get started.

So we'll start with you, Stuart, and the first basic question we have here is what are some of the circumstances where you might need these advanced techniques where things aren't as simple as a simple will?

MR. RITTER:

In the basic situation, most of what's going on is happening essentially at a point in time when you pass away, your assets are distributed over a short period of time and then things are done. So if your goal is to have things happen over a longer period of time, for example, you don't wanna give all of the assets that are going to a minor child to them at a moment in time or have them get everything when they reach the age of majority, or you have some that's harder to separate, like a house or a business, those are situations where more sophisticated techniques allow you to have things happen over time and give you the chance to put in place the things you want to have happen if it's not just within a very short period of time of your death.

MR. YOUNG:

Great. And trusts are one of the techniques that we talk about as a way to meet those special circumstances and accomplish your goals. Why don't

we talk a little bit more about what are the types of trusts and what are the benefits of -- of those different types of trusts. Angela, why don't you -- you help us with that one.

MS. VALLARIO:

Yes, certainly. Well, first of all, I think people need to understand that there are two ways in which you can create a trust. Either through your will, known as a testamentary trust, and like a will it speaks at death and it's funded with probate assets, or during your lifetime, you could create an inter-vivos trust, and that document, as we mentioned earlier, can own property while you're alive, and as part of the trust terms can either be revocable or irrevocable.

MR. YOUNG:

Okay. So those two are just as they sound, right? The revocable you can take it back, you can do things with it. With irrevocable or irrevocable, what -- what part of that can't be changed?

MS. VALLARIO:

Well, the irrevocable trusts are essentially used for gifting during lifetime, but maybe you don't wanna give it outright to a child, so you give it to an irrevocable trust to be held for their benefit with various provisions that would have payout provisions that are other than outright.

MR. YOUNG:

Great. So why don't we talk a little bit about kind of the pros and cons. So again, we talked earlier about the fact that you -- you have the privacy benefit, but there's a cost involved. Maybe we can go into a little more detail on the pros and cons of a trust.

MS. VALLARIO:

Well, a trust is complex. So you have to be willing to accept that complexity even during lifetime or -- or have your trustee after your death manage the property for the benefit of another. It's an -- its own separate entity. It has to file a tax return. It has to report income. So it's complex. And people have to be willing to accept that. In addition, I think that they're costly. There's no question that if you implement a trust in any estate plan, it's going to be much more costly than a simple will.

MR. YOUNG:

Okay. And, Stuart, I'm sure you have some stories about people setting up trusts. You can't just set them and forget them, right?

MR. RITTER:

Absolutely. As Angela pointed out, the trust owns the assets. So one of the things that will happen sometimes is people will have the legal documents drawn up that create the trust but then they'll still keep the asset in their own name. Well, then the trust doesn't have anything that it owns in order to control. It's important to get the legal documents in place and to move the asset into the trust, because if you still own it, the trust doesn't have anything to control.

MR. YOUNG:

Right. Another facet of estate planning that is sometimes associated with trusts is estate taxes and whether or not a trust helps you with minimizing or eliminating estate taxes. So before we get into detail on that, maybe it would help to understand a little bit about how are estate tax calculated. We talked about the fact that, you know, it doesn't apply to everyone, but it might help for those who are interested in the topic how -- how do you come up with an estate tax value?

MS. VALLARIO:

Well, one thing I think individuals need to understand is that all of your assets, regardless of how they are titled, whether they be in a taker on death account, a joint account, all of those assets are pooled in coming up with a federal estate gross amount. To the extent it exceeds this 11.18 million per person is going to be subject to federal estate and gift tax.

MR. YOUNG:

Okay. Very good. And there's also the concept of state estate taxes, and obviously every state can be different, and state inheritance taxes. What should people know about those?

MS. VALLARIO:

Well, I think the inheritance tax which is in a few jurisdictions is imposed regardless of the value of one's estate. It is imposed on beneficiaries that have no blood connection, like a friend would be subject to an inheritance tax, where as typically spouses and children are exempt.

MR. YOUNG:

So a state inheritance tax may or may not be in addition to a state estate tax.

MS. VALLARIO:

Correct. Inheritance tax is imposed on unique beneficiaries, regardless of the value of one's estate. So a very small estate could have inheritance tax imposed.

MR. YOUNG:

So maybe at this point let's go through the calculation of an estate tax and the estate tax liability. What are some of the key things that you can take out of your total estate value to arrive at that estate tax?

MS. VALLARIO:

Well, the gross estate as we previously mentioned includes all of your assets, and from that, there are various deductions like funeral expenses, debts of the decedent, and things of that nature. But the number one single deduction from a gross estate is the marital deduction. We have an unlimited marital deduction. So to the extent that your estate plan is transferring your assets to a spouse, there will be no estate tax, regardless of the value of one's estate.

MR. YOUNG:

Good. And we have on the visual another key one would be charitable transfers. And that's not for everyone necessarily, and certainly not as common as the marital deduction, but -- but, Stuart, I'm sure you've -- you've talked to a lot of clients who are very interested in leaving a legacy in that way.

MR. RITTER:

Absolutely. Charitable bequests are something a lot of people are interested in as they're thinking through who's going to get the assets. They've got some nonprofits that they wanna support, and when you're thinking about that, recognize as Angela said, the money that you give on death to those charitable organizations gets subtracted from what your original estate amount was before we get to the point where we say is this big enough to actually apply federal estate taxes to.

MR. YOUNG:

Good. Now, one thing that I think we wanna make sure people understand, if you give money away during your lifetime, does that help

you to avoid these taxes or are we then worried about something else, the gift tax?

MS. VALLARIO:

Well, you can bring down your estate by making annual gifts of up to $15,000 a year, and that does not -- is not subject to a gift tax. But the fact that you've transferred those properties during your lifetime means that it's not part of your gross estate.

MR. YOUNG:

Good. So -- so that can help, especially if you stay within that annual limit.

MS. VALLARIO:

That's correct.

MR. YOUNG:

Great. So once you get to that taxable estate value, that's the amount that the estate tax is calculated on, and that could be up to 40 percent, right?

MS. VALLARIO:

That's correct.

MR. YOUNG:

Good. So we talked about those types of assets that are included in your gross estate, and we'll come back to this list that we showed earlier of different types of accounts. And what we can see here is, Stuart, pretty much everything here is included in your estate valuation, right?

MR. RITTER:

Yes. If you have control over an asset during your lifetime, that to a large degree is what delineates what gets included in your estate. So accounts that you own by yourself, accounts that you own jointly, things that you may have a beneficiary designation on. You're still the owner of that. So almost everything on the list gets included in your estate valuation. If you've got something that you've moved to a trust and that trust is irrevocable so that you don't have control over it again, that does move it out, but everything else, that's in your estate.

MR. YOUNG:

Very good. And life insurance would be an example also, the life insurance proceeds, the death benefit would be included in your estate, right?

MR. RITTER:

If you own the policy, yes.

MR. YOUNG:

Okay. Very good. So, Angela, maybe help us understand. People do talk about trusts as a way to help you manage your estate tax liability. So in what circumstance would a trust potentially help you?

MS. VALLARIO:

Well, the only trust that could actually minimize your federal estate tax liability would be an irrevocable trust. And to the extent that you make a transfer to an irrevocable trust during your lifetime, the advantage is that it freezes that value for purposes of federal estate taxes. You mentioned life insurance. And life insurance is an ideal product for an irrevocable life insurance trust, because while you're alive, a life insurance policy is typically value much less. So you could transfer it out of your estate while you're alive at a much lower value, have it owned by an irrevocable trust, and then upon your death, the proceeds, the face value of the proceeds, will be received by the trustee, and all of that will be out of your estate to the extent that you did it more than three years prior to death.

MR. YOUNG:

Okay. Great. And that's what some people refer to as an ILIT, right?

MS. VALLARIO:

That's correct.

MR. YOUNG:

Good.

MS. VALLARIO:

Stands for Irrevocable Life Insurance Trust.

MR. YOUNG:

And it's helpful, but if people aren't going to have an $11 million estate, they probably don't need to worry about that.

MS. VALLARIO:

At this point, yes.

MR. YOUNG:

At this point, yes. Of course laws can change.

MS. VALLARIO:

That's right.

MR. YOUNG:

Laws can definitely change. Good. So we talked mostly about the estate tax as a key tax. Stuart, are there other types of taxes that people need to be thinking about?

MR. RITTER:

Yeah. There are a couple of other taxes that come up in the situation where someone passes away. A couple of key ones are if your retirement account, whether it's a 401(k) or an IRA is a traditional account and has pretax money in it, then when your beneficiaries get that money when they make the withdrawal, that money is included in their income. When they calculate their income that year, whatever withdrawal they took out, that's part of it. So that's an income tax that people need to think about.

The other thing very often is if I own a stock or a mutual fund in a taxable account, when I pass away, the cost basis, what is used to calculate what your gain is that you have to pay taxes on, well, that gets moved up to whatever the value of that item was on the day that I died. So if you leave something to somebody that's a stock or a mutual fund in a taxable account, recognize that the taxes you might have had to pay on that if you had sold it while you were alive, that tax liability gets eliminated when they pass away. And the one place that doesn't happen is if you own that stock or mutual fund inside an annuity, you don't have that step up. So there are a couple of these other tax implications that happen. Those are secondary to think about when you're considering what's going on with your estate plan and federal estate taxes.

MR. YOUNG:

So these are nuances to consider. It's most important to figure out who you want to get your assets and in what proportion, but you could also think about their tax situation when you're deciding who gets what.

MR. RITTER:

Absolutely.

MR. YOUNG:

Great. Now, let's suppose that I have some specific goals for my assets. You know, things that are beyond a simple will, potentially. Charity, like we've talked about. Paying for college for a relative. Helping out someone with special needs. In those cases, do we have to wait until we've died and the estate takes effect or are there some things we can do during our lifetime? Stuart, maybe we'll start with you.

MR. RITTER:

Yeah. There are certainly some things you can put in place. The trusts that we've talked about are one way to provide some direction on an asset while you're still alive. There are also different kinds of accounts that people can use if you're charitably inclined, a donor advised fund or a private foundation allows you to get a tax benefit now, and then those assets can be used for charities in the future. So there are a number of different ways for people who want to do specific things with their assets to have that done that don't necessarily require you to wait until you pass away and then the documents take over then.

MR. YOUNG:

Gotcha. But you wanna be careful, right?

MR. RITTER:

Absolutely. The number one thing is to make sure you've taken care of yourself first, that you're confident you have enough money for what you will need. Because things can get uncomfortable and awkward if you've given some money away and suddenly you find yourself with a need, and depending upon where you gave it, there might be no opportunity to get it back. You might want to have some conversations with people who aren't interested in then having those assets -- assets used in a particular way. So first make sure you've taken care of yourself and then start thinking about how your money would go to others.

MR. YOUNG:

Good. So if you are confident that you're ready to give away some assets, we talked a little bit earlier about the annual exclusion, the $15,000 that

you can give away. Maybe walk through a few other examples of ways that you can give money to people and -- and not trigger that gift tax?

MS. VALLARIO:

Yeah. A nontaxable gift can also be made with unlimited medical or educational transfers. So a -- someone who is trying to bring down their estate so that they're under the 11.18 million might consider paying medical expenses for the benefit of a child or grandchild. The important thing to remember is those unlimited medical expenses must be paid directly to the medical facility. In addition, parents and grandparents can make unlimited educational expenses for the benefit of children, grandchildren, great-grandchildren. Once again, this must be paid directly to the institution. You cannot give it to the beneficiary and let them pay their tuition. It has to be paid directly, but it's in -- like the annual exclusion, you can do it on an annual basis, and the beauty of medical and education is that they are unlimited.

MR. YOUNG:

That's -- that's very helpful to know. I'm sure a lot of people don't know that. Now, a lot of people including a lot of our clients, I'm sure, are aware of 529 accounts for college savings. Now, those are subject to limits, correct?

MS. VALLARIO:

That's correct.

MR. YOUNG:

Okay. So there are ways to bundle five years together, but you still have to be aware of those limits, right, Stuart?

MR. RITTER:

Right. One of the special things that a 529 plan allows you to do is take five years of those $15,000 once a year gift amounts and put all five in at the same time without having any gift tax consequences under most circumstances. So you can put five years' worth into the 529 plan and that's something you are able to do with a 529 that you can't do with other accounts.

MR. YOUNG:

Great. And when we -- when it comes to the $15,000 gift per year, a couple can do two of those together, so you can give $30,000 per beneficiary, correct?

MS. VALLARIO:

Yes.

MR. YOUNG:

Good. Ten if -- if you're in that position, which is a nice position to be in, there's a fair amount of flexibility to -- to make those gifts.

MS. VALLARIO:

That's correct. You could make one in December and turn around and make another one in January. It's an annual exclusion.

MR. YOUNG:

Great. So maybe we can talk about a few more specialized techniques. Stuart, you mentioned the -- the donor advised fund and -- and some other ways of -- of giving gifts. Any that you'd like to expand on?

MR. RITTER:

There are just lots of opportunities. You potentially heard some of the terms, charitable trusts or irrevocable trust like the life insurance one that Angela was talking about. So realize that there are a number of tools at your disposal. What's important to start with is have I put something in place that I'm gonna be able to take care of myself while I'm alive, and then for these other goals that I have, let me think about what they are, who and what organizations I want to help, and then seek out some assistance in figuring out which of these tools is the right one to help you implement those goals that you've set up.

MR. YOUNG:

Great. And a good estate attorney of course can help you with understanding pros and cons of those different options.

MS. VALLARIO:

Yes.

MR. YOUNG:

Great. Another situation that can come up that's a little bit more specialized is family businesses. Certainly a lot of our -- our listeners

have -- have businesses, and those may not be the easiest things to divide among their -- their family. Maybe talk -- talk a little bit about some of the options that you have in helping to distribute the value of a family business.

MS. VALLARIO:

Well, closely held businesses present a lot of complexities, but one of the things that people need to think about is having some type of an arrangement between the various parties. It's referred to as a buy-sell agreement, which is essentially a contract in place so that if one partner pre-deceases the other, that instead of the surviving partner being in business with the deceased partner's family, that there is a plan so that the surviving partner could buy the deceased partner's interest in the business. And this is sometimes funded with life insurance as well.

In addition to those complexities, keeping in mind that closely held businesses are very difficult to value, that you need to retain experts in the area to come up with valuations, but once you have done that, a planned gifting program where you're giving away pieces of the business over years makes sense in many situations.

MR. YOUNG:

Great. So you mentioned the -- the life insurance aspect. o, for example, if we were in business together, I would own a life insurance policy on you and you would own one on me? Is that -- that generally the idea?

MS. VALLARIO:

That's correct. Or the business could own one on both of us. As a key man policy and on the death of the first, that would provide cash liquidity for either the other partner or the business alone to buy your interest in the building, if you have pre-deceased me.

MR. YOUNG:

And obviously there's a lot of details with that, but if you own a business, you need to start making these plans. Good.

So we talked about some of these situations and the importance of communication and talking with the people who are closest to us. Stuart, maybe you can help with thinking about how do we start that dialogue. What are the important things to talk about with family members about an estate plan?

MR. RITTER:

Very often the hardest part of that is just opening up the conversation, and communication is key to all of this going smoothly. It's helpful to avoid surprises. It's helpful to make sure people don't get to after you're passed away and finding out then that they are or are not getting something that they were hoping they would get.

The other thing is to talk about the people who you are entrusting to take -- to carry out the actions that you've asked about. So if you've got a power of attorney, talking to the person who's going to be doing that. If you're setting up an executor, having a conversation with them. Because you're putting a lot of things in writing, but there are always nuances about why you're doing something or what your thought process behind it was that is often helpful for people to understand, so when they're taking care of things, they understand what your true intent was.

MR. YOUNG:

Great. And the guardian, another key person if you have young children, you really want to get that ironed out and agreed upon.

MR. RITTER:

Indeed.

MR. YOUNG:

Good. Now, on -- on the flip side of it, what should I know about other people's estate plans and -- and when's it appropriate to ask that question? It might be a little awkward.

MR. RITTER:

It definitely is awkward, and that is something that is important and folks don't think about. If I am potentially the surviving spouse, if I'm potentially a beneficiary, I may have certain expectations about what will happen with some of those assets, especially if they're things and not just money. A house, a business. And it would be helpful for me sometimes to understand what's going to occur. Some of that can prompt somebody who hasn't put a plan in place, so maybe hasn't checked a beneficiary designation for a while or may not have a plan in place to pass along a business that maybe they started as a sole proprietorship that is now much bigger. So I can get some understanding as to what might happen, that can initiate the dialogue. And certainly don't do it in a way, well, what am

I gonna get. But help me understand what your plans are, help me understand what your wishes are so that everybody can be on the same page, and the plans that are put in place are reflecting the wishes of the person who is making that decision and then everyone else can know ahead of time what that's going to be, and it makes what's a very difficult time already when someone passes away a little bit easier, because people have a sense as to what's going to occur and more importantly why.

MR. YOUNG:

So it's definitely a two way street.

MR. RITTER:

Yes.

MR. YOUNG:

Very good. So as we come to the close of our second session here, maybe we can give some recommendations to people on how do you get started. What are the key things to, you know, the key action items that people should be thinking about as they -- as they leave our webcast today?

MS. VALLARIO:

Well, I'll answer that. I think that, number one, people need to get a handle on their assets and how they're titled. Because as we've previously discussed, that's key as to whether or not it's gonna be controlled by a will or passing directly to a beneficiary. Secondly, as we've mentioned time and time again, communicating to respective beneficiaries that might not be treated exactly the same, and also fiduciaries, including guardians, executors, and trustees to make sure that they're on board with managing the property and standing in the -- in your shoes once you're gone.

MR. YOUNG:

Great. Stuart, what do you have to -- to add?

MR. RITTER:

Get started. And if -- for a lot of people if they're still not sure where to go, get some help. There are professionals that help with this, and just reaching out and getting that started, that will get you on the path to putting these things in place, and very often that will bring people a level of comfort and confidence that they've taken some steps they've been meaning to for a while, and now the plan is in place the way they want it to be.

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MR. YOUNG:

Great. And they've -- they've left a good lesson for the people they've left behind and hopefully left them with a good impression of how they took care of their affairs at the end.

Angela, Stuart, thanks so much for joining us here today. We appreciate your expertise, and I'm sure our audience learned a lot about estate planning, both the basics and some more sophisticated techniques that they can take advantage of. You've been watching Demystify Your Estate Plan. Thanks for joining us here at T. Rowe Price. Again, we hope you -- you enjoyed it and learned something. Please fill out our survey. Let us know what we did well and any ideas you have for our future webcasts. And we look forward to seeing you on a webcast sometime in the future.

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