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Estate Planning Part 2: Planning for Distribution of Assets

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In our second of a two part series on Estate Planning, we summarize how the titling of assets and the inclusion of beneficiary designations are key considerations in determining how an estate is passed on. We will also introduce taxation considerations in passing on assets, and briefly summarize advanced estate planning for larger estates. This article does not provide specific legal or tax advice, and we encourage you to consult with your professional advisors (i.e. attorney and CPA) regarding your own estate planning goals. If requested, we can provide a list of qualified attorneys that can help you with your estate planning needs.

Forms of Property Ownership and Will Substitutes

What Are Forms of Property Ownership and Will Substitutes?

After your death, your property is divided into two general categories: (1) probate property and (2) non-probate property. Probate property is all the property that is passed to your beneficiaries by your will. Non-probate property is property that passes outside the will and thus avoids the probate process. Avoiding the probate process means that the property automatically passes to the recipient at your death, ensuring your privacy, and likely saving both time and money.

Generally, there are two ways you can make non-probate transfers of property: (1) through certain forms of property ownership and (2) through will substitutes.

What are Forms of Property Ownership?

You can legally own property in many ways. The way you own property is important because it affects what you can do with it while you own it, how you can dispose of it during life, who receives it at your death, and how taxes and income are apportioned.

Basically, you can own property solely (by yourself), jointly, or as a split interest. Joint or co-ownership refers to concurrent ownership of property by two or more persons. The most common forms of joint ownership include joint tenancy, tenancy in common, tenancy by the entirety, and community property. A split interest is a divided interest in property. Generally, a split interest refers to life estates and remainder interests. In most cases, joint titling of assets bypasses probate and determines who gets the asset upon one's passing.

What Is a Will Substitute?

A will substitute, sometimes referred to as a poor man's will, is a variety of techniques used to transfer property to beneficiaries without using a will.

A trust is probably the most well-known type of will substitute, but there are many others, including payable on death accounts, transfer on death accounts, and beneficiary designations.

Specific Forms of Property Ownership

Sole Ownership

Sole ownership (or outright ownership) occurs whenever you fully own any type of property by yourself. You alone enjoy full use of the property. You alone are responsible for any of the costs associated with the property. In general, you are the only one who can decide how to dispose of the property. If the property you own this way produces income, you have the right to receive all of the income and you will generally be taxed on such income.

Joint Tenancy

Joint tenancy (also called joint tenancy with rights of survivorship or JTWROS) is one of the ways two or more people can own something together. If you are the co-owner of property

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owned as a joint tenancy (a joint tenant), that property passes automatically at your death to the remaining joint tenants without the expense and delay of probate.

Caution: Joint tenancy can exist without rights of survivorship in some states. If this is the case in your state, be sure to be very clear about what type of joint ownership (with or without rights of survivorship) is being created. Also, Colorado is one of a few states that allow joint tenants to own unequal shares.

Tenancy in Common

Tenancy in common is an ownership interest shared by two or more persons in personal or real property. Each owner (called a tenant in common) has a right to use and possess the entire property even though he or she may actually own an unequal share. Shares are proportionate to contributions or determined by agreement. At death, an owner's share passes to his or her beneficiaries and generally must pass through probate. Tenants in common do not have survivorship rights. This lack of survivorship rights distinguishes a tenancy in common from other joint ownership arrangements. None of the tenants has exclusive rights to any part of the property. In most states, if the property produces income from third parties, all tenants are entitled to receive a portion of this income that is based on their proportionate or agreed to interests in the property. Also, tenants are free to transfer their portion of the property without first obtaining the consent of the other tenants.

Tenancy by the Entirety

Tenancy by the entirety can only exist between spouses. If you are the co-owner of property owned as a tenancy by the entirety (a tenant by the entirety), that property passes automatically at your death to your spouse without the expense and delay of probate. Neither spouse can encumber or dispose of the property without the consent of the other.

Caution: A tenancy by the entirety is not recognized in all states (e.g., not available in Colorado).

Community Property

To date, community property laws have been enacted in 10 states: Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin, and Puerto Rico, as well. Community property laws establish a set pattern of property ownership for married couples.

Although the laws vary among these states, some general characteristics are shared by all. In general, community property states consider any income or property acquired by a married couple during their marriage (except for property received by gift or inheritance) to have been earned or acquired by both equally, regardless of which spouse actually earned or contributed it. Each spouse owns a one-half interest in all such income or property. At the death of one spouse, the other is entitled to one-half.

Life Estates and Remainder Interests

A life estate (sometimes called a life interest) is an interest in property for the duration of the holder's (sometimes called a life tenant) life only. A remainder interest is the right to receive whatever is left over when the life estate ends.

Beneficiary Designations

A beneficiary designation is one form of will substitute. It allows you to transfer certain assets, such as the proceeds of a life insurance policy or a retirement plan (e.g., an IRA, 401(k), or 403(b)), to a person or entity without going through probate. You can change your beneficiary at any time at no cost, whereas making changes to a will would likely take more time and some cost. Know that a will or trust does not override any beneficiary designations. In most cases you can name anyone as a beneficiary. You generally can name more than one person as your beneficiary, subject to certain spousal rights for some retirement plans. If you name more than one person, your beneficiaries will receive equal shares unless you specify otherwise. You can also name a charitable institution or a trust as the beneficiary in most cases. In most cases, you should avoid naming your estate as beneficiary. If you do, the money will go through probate before being distributed. Furthermore, the income tax consequences of naming your estate as beneficiary are generally not as favorable as naming individuals as beneficiaries.

Life Insurance and Annuities

You can name anyone you wish as the beneficiary of your life insurance policy or annuity. Although most people choose a family member, such as a surviving spouse or child, you're not required to do that. You can also name a charitable institution or a trust.

Bank Accounts

You could transfer assets under a beneficiary designation on a payable on death (POD) registration.

Brokerage Accounts (Not a Retirement Account)

You could transfer assets under a beneficiary designation on a transfer on death (TOD) registration.

Retirement Plans (IRA, 401(k), 403(b), Pension)

You could transfer assets under a beneficiary designation in the initial application or in a changing form specific to the type of plan. Some corporate retirement plans require you to name your spouse as the beneficiary, unless he or she signs a written waiver consenting to your choice of another beneficiary. And if you live in one of the community property states, your spouse may have rights related to your retirement accounts regardless of whether he or she is named as the primary beneficiary.

Real Estate and Vehicles (Not Held Jointly or in a Trust)

Colorado and some states allow you to leave real estate with

transfer-on-death deeds, thus avoiding probate. These deeds are also called beneficiary deeds. You sign and record the deed now, but it doesn't take effect until your death. You can revoke the deed or sell the property at any time. The beneficiary you name on the deed has no rights until your death.

Some states (not Colorado) also have Transfer-on-Death Registration for Vehicles. To name a transfer-on-death beneficiary, you'll need to fill out the paperwork required by your state's motor vehicles department.

Naming or Changing Beneficiaries

It's a good idea to review your beneficiary designation form at least every two to three years. Also, be sure to update your form to reflect changes in financial circumstances. Beneficiary designations are important estate planning documents. Seek legal advice as needed.

Tip: If you name a child as a beneficiary, you should also appoint an adult to act as guardian of the money. Otherwise, if you die while the child is still a minor, the child's parents (assuming you are not the parent) may have to petition the court to act as guardians. If the child's parents are no longer alive, the child's court-appointed guardian will handle the money. The court's involvement can be costly, time-consuming, and intrusive. It's best to avoid it if possible. The easiest way to name someone as a guardian of a child's property is to appoint an adult as a "custodian" of the money. Custodians are authorized under the Uniform Transfers to Minors Act (UTMA), which most states have adopted.

Designating Primary and Secondary Beneficiaries

When it comes to beneficiary designation forms, you want to avoid gaps. If you don't have a named beneficiary who survives you, your estate will likely end up as the beneficiary, which is not always the best result. If your estate receives your retirement benefits, the opportunity to maximize tax deferral by spreading out distributions may be lost. In addition, probate can mean paying attorney's and executor's fees and delaying the distribution of benefits.

Your primary beneficiary is your first choice to receive retirement benefits. You can name more than one person or entity as your primary beneficiary. If your primary beneficiary doesn't survive you or decides to decline the benefits (the tax term for this is a disclaimer), then your secondary (or "contingent") beneficiaries receive the benefits. Some 401k or pension plans don't allow for the naming of an alternate beneficiary. You must check with your plan regarding its specific rules.

Having Multiple Beneficiaries

You can name more than one beneficiary to share in the proceeds. You would normally want to specify the percentage each beneficiary will receive (the shares do not have to be equal). You should also state who will receive the proceeds should a beneficiary not survive you. Normally when a beneficiary predeceases you and you don't change the beneficiaries, this share upon your passing, would be split evenly between the other living beneficiaries. You can however, in most IRA and Transfer On Death registrations, include a "Per Stirpes" designation for a beneficiary, such that if this person predeceases you, his or her share, upon your passing, will go to his or her children.

Naming a Trust as a Beneficiary

You must follow special tax rules when naming a trust as a beneficiary, and there may be income tax complications. In some circumstances, it's best not to name a trust as the beneficiary. In other cases naming a trust may make sense, especially if you want to add conditions by which money is distributed after your passing. Seek legal advice before designating a trust as a beneficiary.

Naming a Charity as a Beneficiary

In general, naming a charity for a retirement account will not affect required distributions to you during your lifetime. One needs to be careful about naming a charity along with other beneficiaries on the same retirement account if you want the other beneficiaries to be able to take advantage of the tax-deferral possibilities of taking distributions based on their life expectancy.

Income Tax Considerations for Beneficiaries

Death proceeds received under a life insurance policy generally aren't subject to income tax. For annuities held outside of retirement accounts, any gain in value over the contribution amounts are passed through to the beneficiary and such gains will be taxed at the beneficiary's ordinary income tax rate when distributions are made. Bank accounts that are cash or money market accounts generally do not have any tax consequences when passed on. For brokerage or investment accounts that are not retirement plans, the cost basis (amount invested) is adjusted up or down based on the fair market value at death. This adjusted cost basis will determine how much capital gain or loss is reported if the investment is sold by the beneficiary. The cost basis for real estate and business interests are also adjusted based on fair market value.

With the primary exception of Roth IRA's, Roth 401(k)'s, retirement account withdrawals by a beneficiary are for the most part fully taxed based on the beneficiary's ordinary income tax rates. Your choice of beneficiary has an impact on the tax consequences. A spousal beneficiary has the greatest flexibility for delaying distributions that are subject to income tax. In addition to rolling over your 401(k) or IRA to his or her IRA or plan, a surviving spouse can generally decide to treat your IRA as his or her own IRA. These options can provide more tax and planning options.

For example, if your surviving spouse rolls the money over, he

or she does not have to pay income tax until withdrawals start. If the account is left as is, your surviving spouse does not have to pay the 10 percent early withdrawal penalty, even if he or she is under the age of 59½.

When naming a non-spouse beneficiary, that person has the option to directly roll over all or part of your inherited benefits to an inherited IRA. This person has the ability to "stretch out" the withdrawals over his or her life expectancy. This can allow more assets to stay in the retirement account longer, growing tax deferred, thus spreading out the payment of income tax on distributions. Withdrawals can be strategically planned based on other sources of income.

Roth IRA's and Roth 401k's have a huge tax benefit when passed on, in that your beneficiaries can receive the benefits free from income tax if all of the tax requirements are met. Like regular IRA's, current law also allows the ability to "stretch out" withdrawals based on the life expectancy such that investments can continue to grow tax free. These tax advantages mean that you need to consider the impact of income taxes when designating beneficiaries for your 401(k) and IRA assets if Roth accounts are in the mix.

Business Planning

Estate planning for a privately held business can be complex, especially if the business includes non-family owners. The structure of the business (i.e. sole proprietorship, partnership, LLC, corporation) will also have an impact on how assets can be distributed. In most cases regarding a multiple owner business, a buy-sell agreement is a recommended tool to allow for a smooth transition for your business. This contractual agreement controls what happens to company stock after a triggering event, such as the death of a shareholder. It can provide a ready market for the shares in the event the owner's estate wants to sell the stock after the owner's death.

Advanced Estate Planning

Upon listing all your assets, which includes your share (usually half) of jointly held accounts, and the death benefit of the life insurance policies that you own, if your value after subtracting any debt owed is over $5,490,000 in 2017, the value over the exemption amount is subject to an estate tax rate of 40% if you were to pass this year. Married couples can protect a combined $10,980,000 in 2017 from estate taxes. There are many advanced estate planning strategies to reduce or eliminate an estate tax problem. Although we can provide more information on more common strategies, such as gifting to children/grandchildren or donating to charities, we recommend working with a qualified estate planning attorney for possible implementation of more advanced strategies. Advanced planning is also suggested if you have a family member with special needs.

Key 2017 Tax and Retirement Numbers

For your review, the enclosed Key Numbers 2017 reference guide provides an update on current tax brackets/rates and maximum retirement account contributions amounts. Besides consulting with your tax professional for specific tax advice, please let us know if you have questions regarding your individual tax and retirement planning strategies.

Finally, the new administration and Congress may provide an opportunity for significant changes regarding taxation and estate planning laws, and as such, we will likely provide future newsletters regarding tax, retirement, and estate planning as changes do occur.

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Key Numbers 2017

Tax reference numbers at a glance.

Income Tax (2017 tax rate tables)

Single			Married filing jointly		
Taxable income	Tax due	Marginal tax rate*	Taxable income	Tax due	Marginal tax rate*
$0	$0	10%	$0	$0	10%
$9,325	$932.50	15%	$18,650	$1,865.00	15%
$37,950	$5,226.25	25%	$75,900	$10,452.50	25%
$91,900	$18,713.75	28%	$153,100	$29,752.50	28%
$191,650	$46,643.75	33%	$233,350	$52,222.50	33%
$416,700	$120,910.25	35%	$416,700	$112,728.00	35%
$418,400	$121,505.25	39.6%	$470,700	$131,628.00	39.6%

Head of household			Married filing separately		
Taxable income	Tax due	Marginal tax rate*	Taxable income	Tax due	Marginal tax rate*
$0	$0	10%	$0	$0	10%
$13,350	$1,335.00	15%	$9,325	$932.50	15%
$50,800	$6,952.50	25%	$37,950	$5,226.25	25%
$131,200	$27,052.50	28%	$76,550	$14,876.25	28%
$212,500	$49,816.50	33%	$116,675	$26,111.25	33%
$416,700	$117,202.50	35%	$208,350	$56,364.00	35%
$444,550	$126,950.00	39.6%	$235,350	$65,814.00	39.6%

* Rate applies to each additional dollar in taxable income received until the next taxable income threshold amount is reached.

Education Credits and Deductions

MAGI phaseout ranges	Single or head of household	Married filing jointly
Lifetime Learning credit **($2,000 max)**	$56,000 to $66,000	$112,000 to $132,000
American Opportunity credit **($2,500 max)**	$80,000 to $90,000	$160,000 to $180,000
Education loan interest deduction **($2,500 max)**	$65,000 to $80,000	$135,000 to $165,000
U.S. Savings bond interest exclusion for higher-education expenses	$78,150 to $93,150	$117,250 to $147,250

Standard Deduction and Personal Exemption

Filing status	Standard deduction	Personal & dependency exemption	Phaseout threshold*
Single	$6,350	$4,050	$261,500
Married filing jointly	$12,700	$4,050	$313,800
Married filing separately	$6,350	$4,050	$156,900
Head of household	$9,350	$4,050	$287,650
Dependent**	$1,050**		
Additional deduction for blind or aged (over age 65)			
Single or head of household		$1,550	
Married filing jointly or separately		$1,250	

* Phaseout applies to personal exemption & itemized deductions.
** Dependent standard deduction is the greater of $1,050 or $350 plus earned income.

Investment Taxes

Single filer	Married filing jointly	Married filing separately	Head of household	Tax rate
Long-term capital gain & qualified dividend tax (taxable income thresholds)				
Up to $37,950	Up to $75,900	Up to $37,950	Up to $50,800	0%
$37,951 up to $418,400	$75,901 up to $470,700	$37,951 up to $235,350	$50,801 up to $444,550	15%
More than $418,400	More than $470,700	More than $235,350	More than $444,550	20%
Net investment income tax (MAGI thresholds)				
Over $200,000	Over $250,000	Over $125,000	Over $200,000	3.8%*

*The 3.8% net investment income tax (also referred to as the unearned income Medicare contribution tax) applies to the lesser of (a) net investment income or (b) modified adjusted gross income (MAGI) exceeding the above thresholds. It does not apply to municipal bond interest or qualified retirement plan/IRA withdrawals.

Retirement Planning

Employee contribution limits to employer plans*	
401(k) plans, 403(b) plans, 457(b) plans, and SAR-SEPs (includes Roth contributions to these plans)	$18,000
Annual catch-up contribution (age 50+)	$6,000
SIMPLE 401(k) and SIMPLE IRA plans	$12,500
Annual catch-up contribution (age 50+)	$3,000
IRA contribution limits**	
Traditional and Roth IRAs (combined)	$5,500
Annual catch-up contribution (age 50+)	$1,000

* Lesser of these limits or 100% of participant's compensation.
** Lesser of these limits or 100% of earned income.

MAGI phaseout limits for deductible contributions to a traditional IRA (affects taxpayers covered by an employer-sponsored retirement plan)	
Single or head of household	$62,000 to $72,000
Married filing jointly when the spouse who makes the contribution is covered by a workplace plan	$99,000 to $119,000
Married filing jointly when the spouse who makes the contribution is not covered by a workplace plan but the other spouse is covered	$186,000 to $196,000
Married filing separately	Up to $10,000
MAGI phaseout limits to contribute to a Roth IRA	
Single or head of household	$118,000 to $133,000
Married filing jointly	$186,000 to $196,000
Married filing separately	Up to $10,000

Estate Planning

Estate and gift tax	
Annual gift tax exclusion	$14,000
Noncitizen spouse annual gift tax exclusion	$149,000
Top gift, estate, and generation-skipping transfer (GST) tax rate	40%
Gift tax and estate tax applicable exclusion amount	$5,490,000 + DSUEA*
Generation-skipping transfer (GST) tax exemption	$5,490,000**

* Basic exclusion amount plus deceased spousal unused exclusion amount (exclusion is portable).
**The GST tax exemption is not portable.

Social Security/Medicare

Tax rate on earnings	
FICA tax – Employee	
Social Security (OASDI) portion	6.2%
Medicare (HI) portion	1.45%*
FICA tax – Employer (OASDI & HI)	7.65%
FICA tax – Self-employed	
Social Security (OASDI) portion	12.4%
Medicare (HI) portion	2.9%*
Additional employee Medicare payroll tax/ self-employment tax on earnings in excess of specific limits*	0.9%*
Maximum taxable earnings	
Social Security (OASDI only)	$127,200
Medicare (HI only)	No limit

* Additional Medicare tax is assessed on earnings in excess of $200,000 (single filer), $250,000 (married filing jointly), or $125,000 (married filing separately).

Alternative Minimum Tax (AMT)

	Maximum exemption amount	Exemption phaseout threshold
Single or head of household	$54,300	$120,700
Married filing jointly	$84,500	$160,900
Married filing separately	$42,250	$80,450
26% rate applies to AMT income up to $187,800* 28% rate applies to AMT income over $187,800*		

* $93,900 if married filing separately.

Standard Mileage

Standard mileage rates	Cents per mile
Business purposes	53.5¢
Medical purposes	17¢
Moving purposes	17¢
Charitable purposes	14¢

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