THE ESTATE PLANNER



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AN AUDIT CAN BENEFIT YOUR ESTATE PLAN

Settling an estate

After death, what becomes of the deceased's debts?

When making a net gift, the recipient pays the gift tax

Estate Planning Red Flag

How your estate plan accounts for your grandchildren isn't equal

The Michael Law Group, PC

Jonathan W. Michael
Partner

JMichael@themichaellawgroup.com

Main (312) 900 0150
Direct (312) 900 0151
Fax (312) 900 0149

311 South Wacker Drive
Suite 1590
Chicago, Illinois 60606
www.themichaellawgroup.com

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An audit can benefit your estate plan

Changes in gift and estate tax laws in recent years make now an ideal time for an estate plan "audit." During an audit, your advisor or attorney conducts a comprehensive review of your plan to ensure that it continues to operate as intended, remains aligned with your objectives, and conforms to current federal and state laws. An audit can also reveal issues that may lead to disputes among your heirs, delays in the distribution of assets or unnecessary administrative costs.

Take inventory

The first step is to take inventory of your significant assets — including your home and other real estate, bank and investment accounts, business interests, and certain personal property — and ensure they're addressed in your plan and properly titled. Many people use living trusts (also referred to as "revocable" trusts) to direct the distribution of assets after death and avoid probate. These trusts are generally ineffective, however, unless they're "funded" — that is, unless the assets are transferred to the trust.

Estate plan audits often uncover assets intended to be held in the trust but aren't. This is common with assets acquired after the trust was created and initially funded. Unless you transfer these assets to the trust, they'll likely be subject to probate and may not be distributed according to the trust's terms.

Review beneficiary designations

Certain "nonprobate" assets pass to your heirs via beneficiary designation rather than through your will or trust. These may include retirement accounts (such as 401(k) plans and IRAs), life insurance policies, annuities, and certain payable-on-death (POD) or transferable-on-death (TOD) accounts. Absent a valid beneficiary designation, these assets will end up in your general estate and may not be distributed as you intended.

As part of an estate plan audit, your advisor will review all beneficiary designations to ensure they're appropriate and up to date. For example, if an account names your ex-spouse or someone who has died as beneficiary, you should update the designation. It's also a good idea to name contingent beneficiaries for all nonprobate assets. That way, there won't be any gaps in your plan should a primary beneficiary die before you.

Account for family changes

Your advisor will examine changes in family circumstances since you created your plan and determine whether adjustments are needed. For example, births, adoptions, marriages, divorces or deaths may require you to rethink how certain assets are distributed.

Changes in your own marital status are particularly significant. If you recently got married, update your plan to ensure your new spouse is provided for. If you recently divorced, you'll want to revise your plan to ensure that you don't unintentionally benefit your ex-spouse. If you've remarried



Watch out for formula clauses

Many older estate plans used bypass trusts to minimize estate tax and preserve both spouses' federal estate tax exemptions. These trusts usually provided income to the surviving spouse during life, with the remaining assets passing to the children or other beneficiaries, bypassing the surviving spouse's taxable estate.

Typically, these plans used "formula clauses" tied to the exemption amount in effect at the time of death. When the first spouse died, assets up to that spouse's exemption funded the trust, with the balance passing to or for the benefit of the surviving spouse. Today, generous exemptions together with portability make bypass trusts unnecessary for most families. Worse, depending on its terms, an older formula clause may direct all assets to a trust, inadvertently disinheriting the surviving spouse.

Consider this example: George created his estate plan in 2011, when the federal exemption was $5 million, and his estate was worth $7 million. A formula clause provided for an amount up to the applicable exemption to fund a bypass trust, for the benefit of George's children from his prior marriage, with the balance going to his wife, Linda. If George had died in 2011, $5 million would have gone to the bypass trust, and Linda would have received $2 million. Suppose, however, that George dies in 2026, when his estate is worth $12 million. Because the applicable exemption is now $15 million, the formula clause directs all $12 million in assets to the bypass trust. Linda enjoys the income from the trust, but nothing more.

and have children from a previous marriage, consider special planning tools that allow you to provide for your new spouse without disinheriting your children.

Moving to another state may also require you to revise your plan. State laws governing estates, trusts, marital property, and estate or inheritance taxes vary. For example, moving from a state without a separate estate tax to one that imposes such a tax may affect your planning strategies.

Revisit existing planning strategies

Federal gift and estate tax laws have changed dramatically. In the last 15 years, for example, the federal gift and estate tax exemption has tripled from $5 million to $15 million, and portability was introduced. Portability allows a surviving spouse, under certain circumstances, to use a deceased spouse's unused exemption amount.

An estate plan audit may identify certain traditional estate planning structures that, given these changes, are unnecessary or even counterproductive. (See "Watch out for formula clauses" above.)

As part of an estate plan audit, your advisor will review all beneficiary designations to ensure they're appropriate and up to date.

Keep your legacy on track

Creating a well-designed estate plan is an important first step, but the process shouldn't end there. Periodic estate plan audits can help ensure your plan continues to reflect your wishes and accomplish your goals in light of changing laws, family dynamics and financial circumstances. Contact your estate planning advisor or attorney to get the ball rolling.

Settling an estate

After death, what becomes of the deceased's debts?

After a loved one dies, attention often turns to transferring assets to family members and other beneficiaries. But before an estate can be fully settled, another important issue must be addressed: any debt left behind.

Generally, debt doesn't simply vanish when a person dies. Certain obligations may be discharged, but many remain payable by the estate. Understanding some basic rules can help the executor and family members navigate the process.

Executor's role

The executor named to administer an estate generally is responsible for handling both its assets *and* liabilities. One of the first tasks is to identify the deceased's outstanding debt. This typically involves determining whether each debt is legitimate, establishing its priority and deciding how it should be handled during the administration of the estate.

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Some debts may need to be paid promptly, while others can remain outstanding for a period of time. In addition, an obligation attached to a specific asset may follow that asset. For example, a beneficiary who inherits a home may, under certain circumstances, take the property subject to the mortgage associated with it.

Potential liability

Generally, the estate — rather than its executor or beneficiaries — is responsible for paying the deceased person's debts. However, there are exceptions. For example, an individual may have personal responsibility for an obligation if he or she co-signed a loan, was a joint account holder who was contractually liable for the debt or otherwise agreed to share liability for the debt.

State law can also make a difference. In a community property state, a surviving spouse may be responsible for certain debts under applicable community property laws.

Executors face another potential source of liability. Although they normally aren't personally responsible for the deceased person's obligations, they may face consequences for mishandling the estate. An executor who improperly distributes assets, allows them to lose value through mismanagement or pays lower-priority creditors before higher-priority claims could potentially become personally liable.

Estate assets available to creditors

An estate's assets generally are available to satisfy valid creditor claims. This can be true whether property passes through probate or is held in a revocable trust. A common misconception is that placing property in a revocable trust automatically protects it from creditors. Typically, it doesn't.

Some types of property may be exempt from creditors' claims. Depending on applicable law, these may include certain retirement accounts, life insurance proceeds paid directly to a named beneficiary and some jointly owned property.

Assets held in certain irrevocable trusts also may receive creditor protection. For instance, some domestic asset protection trusts are designed to shield assets from claims. The degree of protection varies based on the trust structure and the laws of the jurisdiction governing it.

Note that some states have established homestead exemptions or family allowances that may protect certain property or provide benefits to surviving family members before creditor claims are paid. These provisions are designed to give a deceased person's loved ones a minimal level of financial security in the event the estate is insolvent.

Priority of creditor claims

The order in which debts are paid becomes especially important if an estate is insolvent — that is, its debts exceed the value of its assets. If there isn't enough money to pay every valid claim, higher-priority obligations generally must be satisfied before lower-priority debts.

Although the precise order varies by state, claims commonly receive priority along these lines:

- Costs of administering the estate, including certain legal and accounting fees,
- Reasonable funeral and burial expenses,
- Certain federal taxes and other federal obligations,
- Unreimbursed medical costs associated with the deceased person's final illness,
- Certain state taxes and obligations, which may include Medicaid recovery claims, and
- Other remaining debts.

Secured obligations, such as mortgages, are often treated differently. Because the lender has a claim against the underlying collateral, the beneficiary receiving the property may need to address the outstanding debt to retain it, or the creditor may look to the property itself to satisfy the debt.

Turn to the professionals

Administering an estate involves more than identifying beneficiaries and distributing assets. Executors also must identify valid debts, understand which assets creditors can reach and follow applicable rules regarding the order in which claims are paid. If you've been appointed an executor of an estate, consider working with qualified legal, tax and financial advisors to ensure debts are properly handled.



When making a net gift, the recipient pays the gift tax

If you want to reduce the size of your taxable estate, lifetime gifting can be a powerful estate planning tool. By transferring assets to your children or other family members during your life, you can remove those assets — as well as their potential future appreciation — from your estate.

But gifts of significant value can result in gift tax liability. One strategy that may help address this concern is to make net gifts, an arrangement in which the recipients agree to pay the gift tax associated with the transfers.

How net gifts work

Ordinarily, the person making a taxable gift is responsible for paying any federal gift tax due. With a net gift, however, the recipient agrees, as a condition of receiving the gift, to pay the resulting gift tax.

That obligation affects the value of what the recipient receives. As a result, the amount treated as a taxable gift is reduced by the recipient's obligation to pay the gift tax.

For example, suppose you want to transfer an asset worth $1 million to a family member. In a conventional gift, the taxable value generally starts with the asset's full fair market value, subject to applicable exemptions and exclusions. With a properly structured net gift, the recipient's obligation to pay the gift tax reduces the value of the gift for gift tax purposes.

The calculations can be complex because the gift tax itself depends on the value of the taxable gift. Professional assistance is therefore important when determining whether a net gift will produce the desired result.



When to consider net gifts

A net gift may be particularly useful for someone who wants to make a substantial lifetime gift but is concerned about the gift tax cost. Shifting responsibility for the tax to the recipient can reduce both the gift's taxable value and the donor's out-of-pocket cost.

The strategy may also help advance an estate planning goal of reducing the donor's taxable estate. Rather than using additional assets to pay the gift tax, the donor can potentially retain those funds for other purposes.

Net gifts shouldn't be confused with gifts that qualify for the federal annual gift tax exclusion ($19,000 per recipient for 2026). Gifts within the annual exclusion generally don't use any of the donor's lifetime gift and estate tax exemption amount. Net gift strategies typically become relevant when larger transfers may create taxable gifts.

Look beyond gift tax

Gift tax savings aren't the only consideration. A net gift can have income tax consequences for

both parties. Depending on the circumstances, the recipient's payment of the donor's gift tax may cause the transfer to be treated partly as a sale for income tax purposes. The recipient's tax basis in the transferred property also requires careful analysis.

These issues can be especially important when gifting appreciated assets, such as securities, real estate or interests in a closely held business.

Is a net gift right for you?

Net gifts can provide an additional option for transferring substantial wealth, but the rules and calculations are complicated. The suitability of the strategy depends on the assets involved, the size of the gift, the donor's overall estate plan and the potential tax consequences for both parties. Your estate planning advisor can help you determine if this strategy is right for your family.

ESTATE PLANNING RED FLAG

How your estate plan accounts for your grandchildren isn't equal

In estate planning, dividing assets equally among children may seem like the fairest approach. But equal treatment doesn't always produce equal results for future generations. Every family's circumstances are different, and those differences can complicate decisions about how to distribute assets. Providing for grandchildren is one area where equal division among children can create unintended inequities.



For example: Emma has two children, Jon and Jen. Jon has two children, and Jen has four. Emma's estate plan calls for her $8 million estate to be divided equally between her two children. When she dies, Jon and Jen each receive $4 million. After their deaths, Jon's two children receive $2 million each from their parents' inheritance, while Jen's four children receive $1 million each. (This assumes, of course, that Jon and Jen each preserve the full amount of their inheritances.)

One way to address this inequity is to purchase life insurance. For example, Emma could purchase a policy on her own life, with the proceeds divided equally among her grandchildren. Alternatively, she could arrange policies on the lives of Jon and Jen designed to provide equal amounts to each grandchild. One advantage of this approach is that, so long as Jon and Jen are in good health, the premiums are likely to be lower than those for similar coverage on Emma. Depending on the situation, Emma could use gifts or loans to help Jon and Jen pay the premiums.

Life insurance can allow Emma to provide more for her grandchildren, on a more equal basis, while still dividing her other assets equally between her children. Depending on how Jon and Jen spend their inheritances, Jon's children may still receive more than Jen's on a per capita basis. Still, the additional assets provided by life insurance will likely make Emma's estate plan appear "fairer" in the eyes of her grandchildren.

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Does your estate plan need 'refreshing' for 2027?

Now is the time to find out and get the new year off to a great start.



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The final two months of the year are a great time to get in touch with us to review your estate planning and documents. Does your estate plan still meet your goals? Is the documentation to support your goals up to date? Have there been significant changes in your life or in the lives of those you care about?

Here are some of the most common items that might need refreshing in estate plans and the accompanying documentation.

1. Beneficiaries change or require confirmation. Clients sometimes forget about individuals who no longer occupy an important place in their lives and are designated to receive significant bequests in their wills or trusts. Or they might not understand the laws that apply to beneficiaries. Designating someone as a beneficiary in a will, for instance, doesn't necessarily apply to other investments, such as IRAs.

2. Your family is growing. You're not likely to forget a new addition to your family (immediate or extended) but what about issues related to the guardianship or the management of a child's inheritance? Are the current individuals still able—and willing—to fulfill their responsibilities? Perhaps you want your plan to be more specific about education or special needs.

3. The value of your estate or its makeup has changed. A significant change in your assets or liabilities should trigger a review at any time of a year, but certainly before a new year begins. Have you acquired new property or made new investments—or reduced your holdings? Have you bought or sold real estate or businesses? Is your succession planning current?

4. Executors, trustees, proxies or powers of attorney are no longer appropriate. Has anyone aged, moved away, passed away or simply no longer a good fit? Are they still willing to perform the tasks they have accepted? Carefully consider who will make medical decisions for you and ensure your wishes are followed if you're incapacitated. A financial power of attorney might also be necessary.

5. You get married or divorced. Ensure that your estate plan has been updated to reflect your marital status. For example, if you divorce, will you want your ex-spouse to inherit all or part of your estate? Adopted children or a newly blended family might need to be considered. Naming individuals specifically could avoid conflicts, even lawsuits.

6. You move to a new state or purchase a second residence in a new state. The key thing is to understand how that state's laws, especially tax laws, might affect your planning. Establishing proof that you did in fact change your residency is critical. If you don't, your estate could be taxable under the laws of your former state. Seemingly minor differences—the number of witnesses needed for documents, for example—can be obstacles. New powers of attorney and advance medical directives might be necessary. Ask: Are the people charged with ensuring my wishes are fulfilled qualified to do so in the new jurisdiction? And, just as important, do they still want the responsibility? Get in touch with us to understand and work through these issues. They can have a significant effect on how you think about your taxes.

7. New tax laws are in place. It goes without saying that tax laws are always changing. We know which ones are likely to affect you and which ones aren't. We encourage our clients to review their plans, including documents, with us at least every two years or whenever there are major changes in your life and the lives of your loved ones.

When it comes to estate planning, the adage "change with the times" is one that clearly applies. If you or someone you know is concerned about estate planning, please call us at **312.900.0150** or e-mail me directly at **jmichael@themichaellawgroup.com**. And be sure to visit **The Jonathan Michael Law Group** at any time.

TMLG
The Michael Law Group, PC

The Michael Law Group, PC / 312-900-0150 / JMichael@themichaellawgroup.com

www.themichaellawgroup.com