THE ESTATE PLANNER

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YOU'VE RECEIVED AN INHERITANCE: NOW WHAT?

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An important part of any estate plan, but the terminology can get complex

Avoiding challenges to your estate plan

Estate Planning Red Flag

You own one or more guns

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You've received an inheritance: Now what?

If you've received, or will soon receive, a significant inheritance, it may be tempting to view it as "found money" that can be spent freely. But unless your current financial plan ensures that you'll comfortably reach all your goals, it's a good idea to have a plan for managing your newfound wealth.

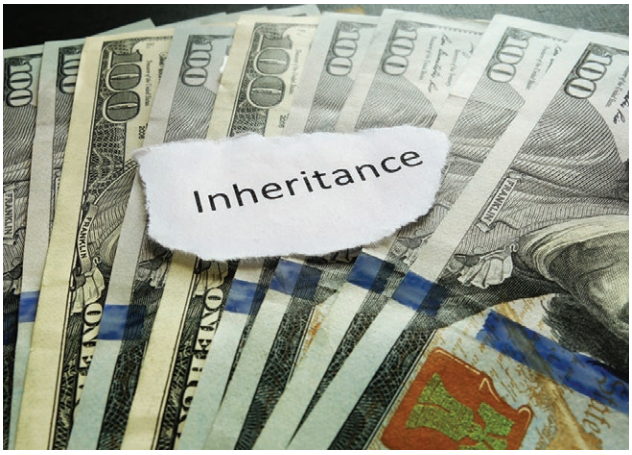
Time for reflection

Generally, when you receive an inheritance, there's no need to act quickly. Take some time to reflect on the significance of the inheritance for your financial situation; consult with a team of trusted advisors (including an attorney, accountant, and financial advisor); and carefully review your options.

While you're planning, park any cash or investments in a bank or brokerage account. If you're married, consider holding the assets in an account in your name only. An inheritance is usually considered your separate property in the event of a divorce, but it may lose that status if it's commingled with marital property in a joint account.

What are the net proceeds?

If your loved one's estate is still being administered, don't spend your inheritance — or make any financial commitments based on it — until you understand what your net proceeds from the estate will be. Once all fees and taxes are accounted for, the final settlement may be less than you expect.



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If you're receiving your inheritance through a trust, talk to the trustee, familiarize yourself with the trust's terms, and be sure you understand the timing and amount of distributions and any conditions that must be satisfied to receive them.

Are there tax consequences?

An inheritance generally isn't subject to income tax, but depending on the types of assets you inherit, they may have an impact on your tax situation going forward. For example, certain income-producing assets — such as real estate, an investment portfolio or a retirement plan — may substantially increase your taxable income or even push you into a higher tax bracket.

If you inherit an IRA or a qualified retirement plan account, such as a 401(k), be sure you understand the rules regarding distribution of those funds. (See "Inheriting a retirement plan" on page 3.)

Depending on the size of the inheritance, it may also have an impact on your estate plan. If it increases the value of your estate to a point where estate taxes become a concern, talk to your advisor about strategies for reducing those taxes and preserving as much wealth as possible for your heirs.

Inheriting a retirement plan

The treatment of an inherited IRA or qualified retirement plan, such as a 401(k), depends in part on your relationship to the deceased. If you inherit an IRA or 401(k) from your spouse, you can usually roll the funds over into your own IRA and allow them to continue growing tax-deferred (or tax-free in the case of a Roth account) until you withdraw the funds in retirement.

At one time, if you inherited an IRA or 401(k) from someone other than your spouse, you could "stretch" distributions over your own life expectancy, maximizing the benefits of tax-deferred or tax-free growth. Now, however, under changes made by the SECURE Act, those distributions generally must be completed within 10 years, with a few exceptions.

For example, if you're less than 10 years younger than the deceased, you can still stretch the distributions over your life expectancy. There are also exceptions for minor children and people who are disabled or chronically ill.

If you inherit an IRA or retirement plan subject to the 10-year payout rule, talk to your advisor about the best strategy for distributing the funds. Depending on the type of plan and your financial circumstances, it may make sense to withdraw the funds in equal installments over 10 years, to keep the funds in the account as long as possible or to make irregular withdrawals over the 10-year period to minimize the tax impact.

Do you need additional insurance coverage?

After receiving a large inheritance, you may need to adjust your insurance coverage. For example, if you inherit real estate or valuable personal property, you may need to increase your property and casualty coverage.

In addition, because greater wealth makes you a more attractive target for lawsuits, you should consider purchasing an umbrella liability policy or increasing the coverage of an existing policy. You may also wish to purchase additional life insurance.

Will inherited assets affect your financial plan?

Treating an inheritance separately from your other assets may encourage impulsive, unplanned spending. A better approach is to integrate inherited assets into your overall financial plan.

Consider using some of the inheritance to pay down credit cards or other high-interest debt or to build an emergency fund. The rest should be available, along with your other assets, for funding your retirement, college expenses for your children, travel or other financial goals.

Have a plan

If you receive a sizable inheritance, there's nothing wrong with taking a small portion of it and splurging a bit. But for the most part, you should treat inherited assets as you'd treat the assets you've earned over the years and incorporate them into a comprehensive financial plan. You'll also want to address any inherited assets in your estate plan. Contact your estate planning advisor for more information.

Health care directive

An important part of any estate plan, but the terminology can get complex

A health care directive is a critical piece of your overall estate plan. Why? It allows you to communicate your preferences in advance for medical care in the event you're incapacitated and cannot express your wishes.

However, depending on your jurisdiction, a directive can go by several different names, including living wills, advance medical directives and directives to physicians. Let's look at various terms you should be familiar with when creating your health care directive.

Health care power of attorney

Comparable to a durable power of attorney that gives an "agent" authority to handle your financial affairs if you're incapacitated, a health care power of attorney (or medical power of attorney) enables another person to make health care decisions for you. This is also called a "health care proxy" in some states.

A living will is a legal document that establishes criteria for prolonging or ending medical treatment.

Choosing an agent is critical. You probably can't anticipate every situation that might arise — virtually no one can — in which it's likely that someone will have to make decisions concerning your health. Therefore, the agent should be a person who knows you well and understands your general outlook. Frequently, this is a family member, close friend or trusted professional.

Remember to designate an alternative and successor in the event your first choice is unable to do the job.

Living wills

A living will is a legal document that establishes criteria for prolonging or ending medical treatment. It indicates the types of medical treatment you want, or do not want, in the event you suffer from a terminal illness or are incapacitated.

This document doesn't take effect unless you're incapacitated. Typically, a physician must certify that you're suffering from a terminal illness or that you're permanently unconscious. Address common end-of-life decisions in your living will. This may require consultations with a physician.

The requirements for living wills vary from state to state. Have an attorney who's experienced in these matters prepare your living will based on the prevailing laws.

DNRs and DNIs

Despite the common perception, it's not a legal requirement for you to have an advance directive or living will on file to implement a "do not resuscitate" (DNR) or "do not intubate" (DNI) order. To establish a DNR or DNI order, discuss your preferences with your physician and have him or her prepare the paperwork. The order is then placed in your medical file.

In fact, even if you already have a living will spelling out your preferences regarding resuscitation and

intubation, it's still a good idea to create DNR or DNI orders when you're admitted to a new hospital or health care facility. This can avoid confusion during emotionally charged times.

POLSTs

Finally, in some states, an estate plan may include a document known as a "physician order for life-sustaining treatment" (POLST) or a similar name. A POLST may be used by a person who has already been diagnosed with a serious illness.

This document doesn't replace your other directives. Instead, it complements other directives to ensure you receive the treatment you prefer in case of an emergency. Your physician completes the form based on your instructions and personal conversations.

The POLST is posted by your bedside if you're hospitalized. If you're residing at a health care facility, it should be prominently displayed where medical or emergency personnel can easily view it.

Processes and documents vary by state

Advance directives must be put in writing. Each state has different forms and requirements for creating these legal documents. Depending on where you live, you may need to have certain forms signed by a witness or notarized. If you're unsure of the requirements or the process, contact an attorney for assistance.

Review your advance directives with your physician and your health care agent to be sure you've accurately filled out the forms. Then let all the interested parties — including your attorney, physician, power of attorney agent and family members — know where the documents are located and how to access them.

Turn to the experts

Understanding all the terms associated with a health care directive can be difficult to keep straight. Turn to your estate planning advisor and your attorney with specific questions as they relate to your state.

Avoiding challenges to your estate plan

A primary goal of estate planning is to ensure that your wishes are carried out after you're gone. So, it's important to design your estate plan to withstand potential will contests or other challenges down the road. The most common grounds for contesting a will are undue influence or lack of testamentary capacity. Other grounds include fraud and invalid execution.

There are no guarantees that your plan will be implemented without challenge, but there are strategies you can use to minimize the possibility.

Dot every "I" and cross every "T"

The last thing you want is for someone to contest your will on grounds that it wasn't executed properly. So be sure to follow applicable state law to the letter. Typically, that means signing your will in front of two witnesses and having your signature notarized. Be aware that the law varies from state to state, and an increasing number of states are permitting electronic wills.

Treat your heirs fairly

One of the most effective ways to avoid a challenge is to ensure that no one has anything to complain about. But making all your heirs happy is easier said than done.

For one thing, treating people equally won't necessarily be perceived as fair. Suppose, for example, that you have a financially independent 30-year-old child from a previous marriage and a 20-year-old child from your current marriage. If you divide your wealth between them equally, the 20-year-old — who likely needs more financial help — may view your plan as unfair.

Demonstrate your competence

There are many techniques you can use to demonstrate your testamentary capacity and lack of undue influence. Examples include:

- Have a medical practitioner conduct a mental examination or attest to your competence at or near the time you execute your will.
- Choose witnesses you expect to be available and willing to attest to your testamentary capacity and freedom from undue influence years or even decades down the road.
- Videotape the execution of your will. This provides an opportunity to explain the reasoning for any atypical aspects of your estate plan and will help refute claims of undue influence or lack of testamentary capacity. Be aware, however, that this technique can backfire if your discomfort with the recording process is mistaken for duress or confusion.

Consider a no contest clause

Most, but not all, states permit the use of no contest clauses. In a nutshell, it will essentially disinherit any beneficiary who challenges your will or trust.

For this strategy to be effective, you must leave heirs an inheritance that's large enough so that forfeiting it would be a disincentive to bringing a challenge. An heir who receives nothing has nothing to lose by challenging your plan.

Use a living trust

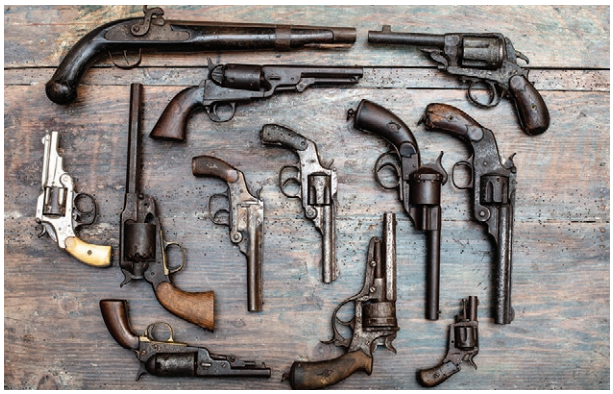
By avoiding probate, a revocable living trust can discourage heirs from challenging your estate plan. That's because without the court hearing afforded by probate, they would have to file a lawsuit to challenge your plan.

Avoid surprises

If your estate plan does anything unusual, it's critical to communicate the reasons to your family. For example, if you're leaving the bulk of your wealth to charity or disinheriting a family member, explaining your motives to your heirs can go a long way toward avoiding misunderstandings or disputes. They may not like it, but it'll be more difficult for them to contest your will on grounds of undue influence or lack of testamentary capacity if your reasoning is well documented.

ESTATE PLANNING RED FLAG

You own one or more guns



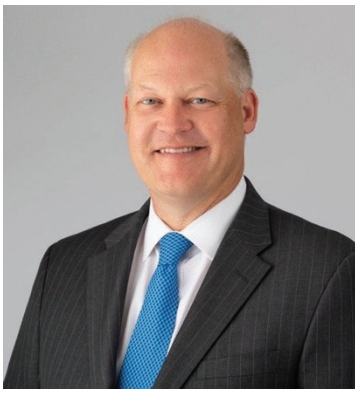
When it comes to estate planning, not all assets are created equal. If you own one or more guns, careful planning is required to avoid running afoul of complex federal and state laws. Without proper planning, there's a risk that the government will confiscate your guns or that the executor of your estate, your trustees or your beneficiaries will inadvertently commit a felony.

Guns are unique among personal property because federal and state laws prohibit certain persons from possessing firearms. For example, under the federal Gun Control Act, "prohibited persons" include convicted felons, fugitives, unlawful drug users or addicts, mentally incompetent persons, illegal or nonimmigrant aliens, persons dishonorably discharged from the armed forces, persons who have renounced their U.S. citizenship, and persons convicted of certain crimes involving domestic violence or subject to certain domestic violence restraining orders.

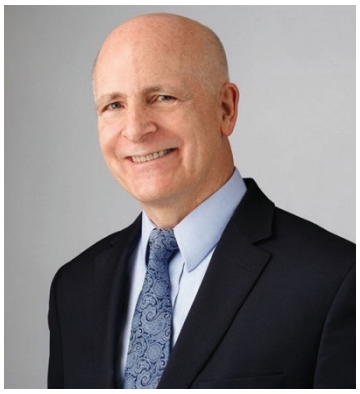
Other persons may be prohibited from receiving firearms under state or local laws. These restrictions apply not only to your beneficiaries, but also to executors or trustees who come into possession of firearms.

Under federal law, certain firearms — such as short-barreled rifles, shotguns and fully automatic machine guns — must be registered (with the Bureau of Alcohol, Tobacco, Firearms and Explosives) to a transferee by the transferor. And additional steps must be taken when transporting these firearms across state lines. For other types of firearms, states may require registration and may impose mandatory background checks, permits and other requirements for firearms transported across state lines.

Given the complexity of federal and state gun laws, and the stiff penalties for violating them, it's critical to consult knowledgeable advisors when providing for guns in your estate plan. You might also consider creating a gun trust — with a trustee who has expertise on gun laws, safety and storage protocols, and transfer requirements — to facilitate the process.



Jonathan W. Michael, JD, LL.M



John E. Fish, JD, CPA

William Ivey, JD, LL.M.

New Federal Exclusions and Exemptions

(and New Planning Opportunities)

As of January 1, 2022, the new inflation-adjusted figures most relevant to the estate and gift tax areas are as follows:

- Applicable Exclusion Amount: $12.06 million per taxpayer
- Generation-Skipping Transfer Tax Exemption: $12.06 million per taxpayer
- Annual Exclusion: $16,000 per donor
- Foreign Spouse Annual Exclusion: $164,000
- Federal Estate Tax Rate: 40%
- 37% Income Tax Bracket for Trusts and Estates begins at: Income over $13,450

The Illinois estate tax exemption remains at $4 million per taxpayer.

Because many clients make annual gifts to children, grandchildren and friends, we encourage our clients to incorporate the 2022 increase into their annual gift giving strategies.

Estate Planning and Tax Expertise

All of the attorneys at TMLG have advanced degrees in taxation - either a Master of Laws degree (in Taxation) or are licensed Certified Public Accountants.

Recently, we welcomed new Of Counsel Attorney John E. Fish to the TMLG team. For more than 30 years John's practice has been focused in the estate and gift tax area. John is both a lawyer and a CPA, and specializes in estate planning, and estate and trust administration.

In 2021 we welcomed associate attorney William Ivey. William specializes in estate planning, and estate and trust administration for individuals, families and business owners.

The Michael Law Group, P.C. is licensed to practice law in Illinois, Florida and South Carolina.

Creating your legacy is our business. If you would like to discuss how recent changes in the tax laws might impact your estate plan, please feel free to contact us at: (312) 900-0150 or https://themichaellawgroup.com/contact-us.