

William Blair

Private
Wealth
Management

Avoid the Most Common Mistakes in Estate Planning

Estate planning is all about your legacy.

A well-planned estate plan is one that meets your goals and avoids unnecessary costs, delays, and conflicts. The last thing you want to leave your heirs is your finances in disarray during a time that is already difficult.

The good news is that the most common errors in estate planning can be avoided.

This paper highlights some common pitfalls in estate planning.

Donating cash to charities rather than stocks

It is generally ill-considered to donate cash rather than appreciated (or “low basis”) stocks to charities, especially those that have greatly increased in value over time.

Using the latter option actually creates a significant win-win for both the donor and charity.

There can be a significant cost to converting an appreciated security to cash. The donor must pay federal income tax and often state tax on any gains in the stock. But if the donor gives the unsold stock outright to the charity, neither the charity nor the donor is taxed on the gain.

For example, an Illinois resident would like to give \$100,000 to his alma mater and cashes in a stock valued at \$100,000, held longer than a year, to make the contribution. Assume his initial investment in the stock was \$45,000 and he is in the highest tax bracket. By selling the stock to fund the gift, the donor would be responsible for paying 20% federal capital gains tax, 3.8% Medicare surtax, and 4.95% Illinois income tax on the \$55,000 capital gain, equaling approximately \$15,800 in taxes.

The donor would spend \$115,800 to give the school \$100,000. Had he donated the low-basis stock to charity, he would not pay taxes on the gift, the nonprofit charity could sell the stock with no tax implications, and the donor would receive a tax deduction equal to the full fair market value of \$100,000.

Charitable Mistake: Donating Cash vs. Appreciated Securities

Example: \$100K donation goal; \$45K basis & \$55K appreciation

	Donate Cash Proceeds	Donate Securities
Federal Capital Gains and Medicare Surtax (23.8%)	\$13,090	\$0
Illinois Tax (4.95%)	\$2,723	\$0
Charitable Donation Goal	\$100,000	\$100,000
Economic Cost to Make \$100K Contribution	\$115,813	\$100,000

Leaving IRA, 401K and other retirement assets to heirs

Assets in retirement plans are among the most inefficient assets to own at death. The full value of IRAs and other retirement plans at one’s death is subject to federal estate tax. In addition, heirs will be responsible for income taxes when they take distributions from these accounts. If you plan to leave money to charity as part of your estate plan, consider giving IRA assets. Doing so ensures that these assets will avoid the double tax burden, leaving more to your favorite charities and less to the tax collector.

It is worth noting that the rule allowing taxpayers who are 70 1/2 or older to transfer up to \$100,000 (or \$200,000 per couple if each owns an IRA) directly from their IRA to a charity has been permanently extended. Taking advantage of this rule can be a great way to accomplish three goals at once: you can make a charitable donation, meet the required minimum distributions (RMD) rules, and avoid recognizing those distributions as taxable income.

Neglecting to update your estate plan

All too often families may have dutifully completed their estate plan 5, 10, or even 15 years ago but neglect to update it.

It is recommended that you review your estate plan every three to five years or on the occasion of a significant life event, such as a marriage or divorce. Perhaps your wealth has changed, grandchildren have arrived, or there has been a death in the family. Maybe you have been reconsidering a primary trustee or beneficiaries of the estate. These revisions need to be reflected in an up-to-date estate plan.

As part of this process, you should also review beneficiary designations on insurance policies, annuities, and retirement accounts. The beneficiary designation—not your primary trustee managing the estate disbursement—dictates who inherits each of these assets. If there is a discrepancy between the two, the beneficiary designation in most cases will supersede the trust. It is also critical that asset titling is correct and up to date.

Not safeguarding the estate from divorce

About half of today's marriages in the United States end in divorce. Prudent planning ensures that your estate is not affected adversely by a divorce.

Prenuptial agreements should be considered as a business-as-usual option, especially for high-net-worth individuals and families. By clearly stating how a couple's assets will be divided if the marriage fails, a prenup can protect the estate's assets, including a family business.

In addition to stating which assets are considered separate property versus marital property, a prenup can define alimony, inheritances, and other important considerations that might otherwise be determined by a court.

Trusts can also be set up to prevent inheritances from becoming marital property in a divorce. Care must be taken in particular to ensure that the income generated by the assets in the trust is not commingled with the spouse's assets.

Passing on your legacy outright rather than in trust

Distributing your estate outright, rather than in trust, can leave your heirs' inheritance vulnerable to creditors, predators, or their own bad judgement. And it's not just minors you need to worry about. Even adult children are often not mature or experienced enough to handle receiving a substantial amount of money. Leaving your inheritance in a trust allows you to establish some oversight or control over the money.

Having a non-estate lawyer set up your estate plan

Hiring an estate planning specialist to handle your affairs may cost more than hiring a generalist, but it is usually money well spent. Poorly written estate documents can lead to more questions for heirs and their lawyers, ultimately costing families more time and money in the long run.

When you consider the impact your inheritance may have on your heirs or the charities you support and the estate tax dollars involved, engaging a good estate

planning attorney to execute sound planning should be an easy decision.

Ignoring formalities in tax laws

The calls for tax reform are as loud as ever: at present, the federal tax code and regulations are thousands of pages long and have grown to more than 10 million words. In them are explicit rules and procedures a good attorney will know and advise on. Choosing to ignore them is a quick and easy way to derail even the best planning. If you are audited—and keep in mind that while the risk of audit is low for most people, it increases significantly if you are a high earner or a high-net-worth taxpayer—the auditor does not consider ignorance of the law a defense.

Consider this: Several years ago the IRS disallowed an \$18 million charitable deduction. The IRS acknowledged that the taxpayer made the contribution and that the value of the contribution was accurate. But it disallowed the deduction because it did not include items the IRS required for it to be considered a “qualified” appraisal.

Failing to protect assets

In travel, in health, in business, and in everyday life, plan for you and your heirs to be properly protected. A lawsuit can be devastating and result in a catastrophic loss for an estate.

You may wish to consider liability insurance to protect you from the risk of being sued and held legally liable for something such as injury or negligence.

If your child stands to inherit substantial wealth, he or she may need broader coverage—similar to yours—for risk protection.

In addition, you may want to consider the value of using limited liability corporations to protect you and heirs from possible personal liability suits against large estate fortunes.

William Blair Advisors

At William Blair, our wealth advisors are dedicated to helping high-net-worth families build and preserve their wealth and create an enduring financial legacy for generations to come. Through an ongoing dialogue with our clients, we deliver comprehensive wealth management solutions for our clients' evolving needs.

Goals such as preserving family wealth, transferring ownership of a family business, and supporting younger generations as they launch their careers and start their families involve myriad considerations related to portfolio management, taxes, risk management, matrimonial law, and estate planning.

William Blair can work with you to help you meet your long-term financial goals.

Additional Resources from William Blair

You can access other financial planning resources by visiting www.williamblair.com/PWM-resources or contact us: PWM@williamblair.com

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