Why 2010 is the Year You Should Pay Closer Attention to Your Estate Plan

Estate planning is an essential part of anyone's personal finances -- no matter how wealthy you are. But even for those who have been diligent about planning for their spouses and heirs, this is a year when it may make particular sense to re-examine your strategy.

With the nonstop flurry of legislative activity in Washington, Congress has still not acted on the phase-out this year of the estate tax. If nothing is done this year, the heirs of any person who dies in 2010 won't be liable for any federal estate taxes, no matter how big the estate. (The carryover basis rules for 2010, however, may give rise to additional planning considerations.)

Yet the potential bad news will come next year when the estate tax is scheduled to return with a vengeance on all estates over $1 million in size (the threshold was $3.5 million for individuals in 2009) with a potential return to a 55 percent top tax rate..

It's worth a trip to your estate planner and your financial planner to help ensure your paperwork is in order and the previous plans you've made won't cause problems.

Family trusts – also called bypass or credit shelter trusts – are of particular concern. These trusts work this way: Individuals add what's known as a formula clause to their will or revocable trust that distributes up to the maximum amount of assets that can pass free of estate tax to the trust if the individual dies before their spouse. The creation of the trust helps ensure that once your spouse dies, neither these assets nor any appreciation on them will be subject to estate tax. But if you die this year, a failure to address the formula clause could potentially cause you to unintentionally disinherit your spouse.

The bottom line: It's worth making a call to a financial planner and your estate attorney to make sure your plans are still in order.

And what if you've never made an estate plan? Even if you're not particularly wealthy, you definitely need one. Here are some specific things you should do and make sure you have in place:

Make a financial plan: You can't have a very effective estate plan without a full grip on your finances. First, sit down with a financial planner to gain an understanding of all the various aspects of your finances from your income and investments to your debt. Add various facts about your family situation to the mix, and that's the starting point for an estate plan.

Make a will your first priority: Unless you have a very complicated estate, a standard will with wording common to your state may be satisfactory to properly dispose of your assets, but it's generally a good idea to get feedback from an estate attorney to make sure your will fits you and your financial structure.

Create all necessary directives: It's important to create a durable power of attorney to oversee financial issues and a healthcare proxy to appoint a trusted individual to oversee health-related decisions if you are unable to do so for yourself. Some states will allow you to appoint more than one individual in each role to allow for checks and balances, but it's particularly important to work with an experienced estate attorney to make sure things are done right.

Establish guardianship and financial directives for your children: If you and your spouse were to die at the same time, who would take care of your kids? Based on your state's requirements, your decision may need to be written up as part of or an addendum to your will. It's also a good idea to name alternates in case the people you name have a change of heart for any reason, or if something happens to them. If your children are to inherit substantial assets or insurance proceeds, it is also wise to make sure that their guardians are qualified to handle that money. If not, someone else should be legally named to do so.

Review all beneficiary information: Make sure all your beneficiary designations on retirement accounts, insurance and other assets not distributed through your will or trust are current and clear.

Consider transferring IRA assets to a Roth: You'll take a tax hit with the conversion, but converting traditional IRAs into Roth IRAs removes another headache for your heirs because no income tax will be assessed once the funds are withdrawn, assuming certain requirements are met.

May 2010 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Marnie Aznar, MBA, CFP ®, a local member of FPA.