



THE  
NORTHERN TRUST  
INSTITUTE

# A STRESS TEST FOR YOUR ESTATE PLAN

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YOUR ESTATE PLAN IS CRITICAL TO HELPING YOU FULFILL YOUR GOALS FOR YOUR FAMILY AND PHILANTHROPY. BUT ARE THERE ANY SURPRISES LURKING IN YOUR PLAN?

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As your wealth grows, so too does the complexity of your wealth planning decisions. It takes careful consideration and insightful guidance to avoid unintended consequences and ensure your plan will unfold as you want it to.

A critical step in the planning process is to “stress test” your estate plan by modeling how your current plan would play out if you were to pass away today. This framework will help determine if anything needs to be changed by answering important questions, such as:

- What will it feel like for your spouse and/or children to live with your plan after you are gone?
- How will distributions be made to them and what will they need to do to receive them? What type of expenses can the money be used for? Who will make those decisions?
- Will your beneficiaries get stuck with an unexpected – and unaffordable – tax bill?
- Is your plan flexible enough to adapt to future changes in your family situation or tax laws?

Going through this process usually results in some surprising findings which, if left unaddressed, can cause your plan to go awry. Uncovering these issues ahead of time offers powerful opportunities to perfect your plan long before it comes time to settle your estate. Here are eight of the most common surprises and how you can learn from them.



## HOW MUCH WILL MY KIDS RECEIVE AND HOW WILL THEY RECEIVE IT?

Many times, assets will be distributed outright to your children or grandchildren. While this can allow for maximum control and flexibility for your beneficiaries, they may not be prepared to manage that much money on their own or you may be placing those assets into their hands at an inopportune time, making them subject to creditor claims.

### SOLUTION:

Evaluate the ages of your beneficiaries, amount of each distribution, their ability to manage investments, and the options for providing assets to them. Instead of an outright distribution, you may want to consider keeping those assets in trust for their benefit. This will allow for asset protection, help to maximize your gift, estate and GST tax exclusions and ensure your beneficiary will have “guardrails” in the form of a trustee who can help manage the assets, make investment decisions, and assist the beneficiary in financial management.



## MY TRUST PROVISIONS DO NOT ALIGN WITH MY GOALS FOR MY FAMILY.

What seems like simple language can translate into meaningful differences in the way your beneficiaries will receive money from trusts and how they can use it. For example, estate plans often indicate either a “maintenance” or “best interests” standard, which are provisions that determine how a trustee may distribute the income and principal in a trust. If you want your beneficiaries to be able to get a distribution from the trust to buy a desired house or start a business, a maintenance standard may not suffice.

### SOLUTION:

Carefully review trust provisions with your advisors to make sure they align with your intentions. Be sure to talk in real life terms of “what will this enable my spouse and children to do” or “what types of things can they spend the money for” to make sure you and your advisor are on the same page and get the right language built into your documents.

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## I OWE HOW MUCH IN ESTATE TAX?

If your taxable estate is above federal and/or state estate tax exemption amounts, understanding your estate tax liability is critical. Many people do not realize certain assets are included in their estate for estate tax purposes, such as individually-owned life insurance. Also, numerous states have exemption amounts far below federal limits, so you may owe state estate tax and not be aware of it. These exemption amounts change on a regular basis, so monitoring changes with your advisors is important.

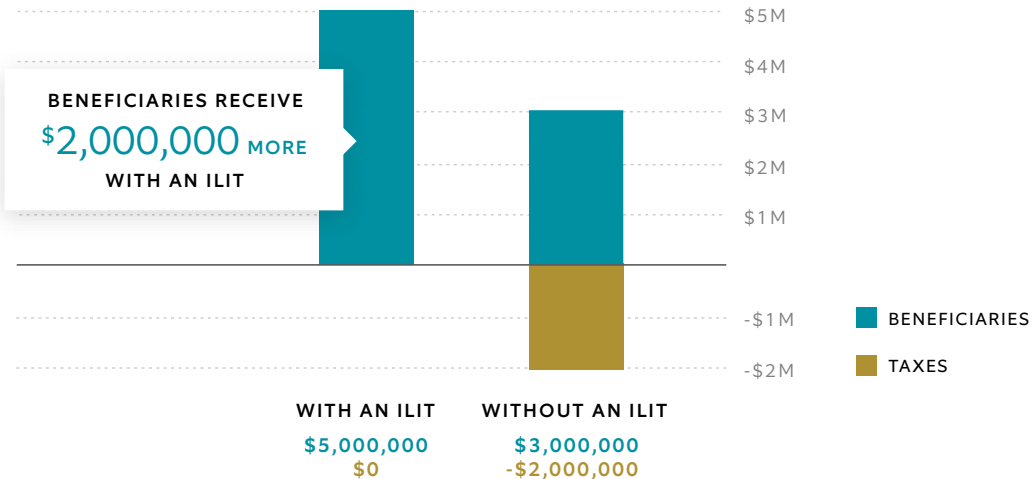
### SOLUTION:

Minimize the estate taxes you would owe by taking action now. If you are confident you have enough wealth to support your lifetime goals, various wealth transfer strategies can move excess wealth – and future growth on the assets you transfer – out of your taxable estate. If you will owe state estate taxes, you may want to reconsider your state of domicile.

### ONE TRANSFER STRATEGY: EXCLUDE LIFE INSURANCE PROCEEDS FROM YOUR TAXABLE ESTATE

Life Insurance Policy Value:  
\$5,000,000

Estate Tax Due Without an Irrevocable Life Insurance Trust (ILIT): **\$2,000,000**  
(\$5,000,000 × 40% Federal Estate Tax)



The above example illustrates an ILIT's value after death for a client with assets in excess of \$23,200,000 and a \$5,000,000 life insurance policy. Consider that funding an ILIT may involve the utilization of annual exclusion gifts and/or gift and GST tax exclusions. The information contained herein is illustrative and for informational and educational purposes only. No representation is being made that any actual ILIT will achieve the same results as the illustration.



#### IT'S MY PASSION, BUT IS IT YOURS?

Passion assets, such as your beloved vacation home or art collection, are an important part of both your legacy and wealth transfer plan. But they come with a host of complex estate planning concerns because they can be difficult to value, hard to sell and expensive to maintain. These assets may mean a lot to you, but what about to your children? Will they be as interested in keeping the family vacation home, and if so, how will siblings share the home?

#### SOLUTION:

To minimize family discord, discuss the assets your beneficiaries wish to keep and develop a plan to ensure your estate plan has sufficient liquidity to cover the related expenses. Maintaining illiquid assets that do not produce steady income comes with a cost. For those assets your beneficiaries may not want to keep, develop a plan now for how those assets will be sold or possibly gifted to charity.



#### I AM NOT LEVERAGING ALL AVAILABLE GIFT TAX EXCLUSIONS.

Using your lifetime gift tax exclusions not only removes assets from your estate, but all future appreciation on those assets as well. Assets that have high growth potential are ideal candidates for lifetime wealth transfer planning. If you wait until you die to use your exclusions, you get a dollar to dollar alignment of exclusion to assets. However, consider what happens if you gift that asset today, then apply an exclusion and live another 20 years. That \$1 gift has grown to be worth \$20. You've leveraged \$1 of your lifetime gift exclusion to give 19 more \$1 gifts -- tax-free -- to your beneficiaries.

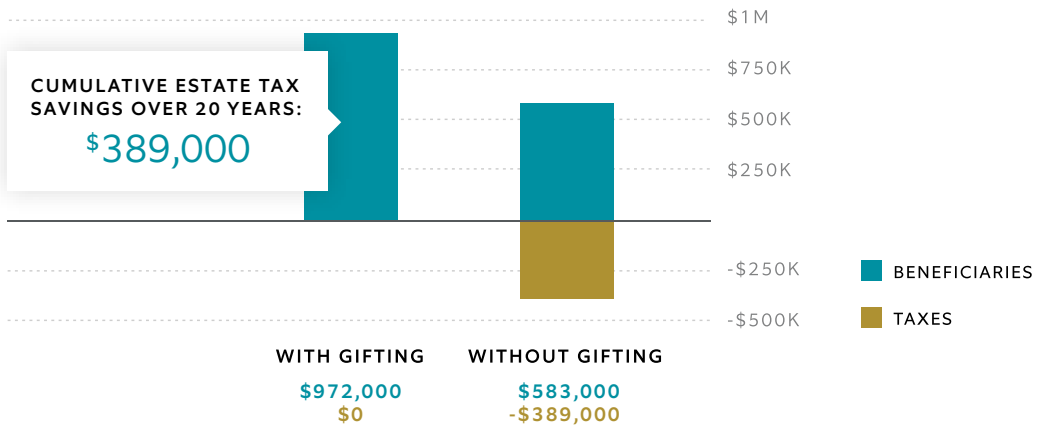
#### SOLUTION:

Do you regularly make annual exclusion gifts and have you used up your entire lifetime gift tax exclusion? It is important to carefully consider how assets are owned by spouses, which assets to transfer and which strategies to employ to be most efficient. For example, some assets can be discounted for gifting purposes to more effectively leverage your available gift exclusions. There may also be opportunities to move additional assets outside of your taxable estate by setting up a trust and continuing to pay income tax on the trust assets after the gift has been completed. As an added bonus, while many states have an estate tax, only one state, Connecticut, has a gift tax in 2020.

## THE VALUE OF LIFETIME ANNUAL EXCLUSION GIFTING

Estate Tax Due Without Gifting: **\$389,000**

(\$972,000 × 40% Federal Estate Tax)



The annual gift tax exclusion amount is subject to change. The example above assumes a married couple, with assets in excess of the existing estate tax exclusion amount, each gifting \$15,000 (\$30,000 total) per year for 20 years. The example above shows a 5% growth rate for illustrative purposes. If the illustrative portfolio would have been an actual portfolio, it would have been subject to market and economic conditions, fees and costs that could have materially impacted performance and the results illustrated above.



## MY FIDUCIARY DESIGNATIONS ARE OUTDATED

Because relationships and circumstances change over time, you may be surprised to recall who you have named a fiduciary -- the person or entity that will ensure that your plan is carried out according to your wishes -- including your agents for healthcare and property, the trustee of your trust or trusts and the executor of your estate. For example, parents often name older children as trustee for younger children, but over time that can result in family conflict. Adult children commonly name parents when they first create an estate plan, but these designations should be reconsidered as parents age. Spouses often name one another as fiduciaries and commonly overlook updating appointments following a divorce. Lastly, acting as an agent, trustee or executor can be a lot of work, and require time and skill sets that the people you have named may not possess.

### SOLUTION:

Keep a comprehensive list of the various fiduciary appointments (e.g., agents, trustees and guardians) named in your estate plan. Regularly revisit your appointments to update and ensure that you have the right people named. Consider adding a corporate fiduciary for professional support and management.



## HOW DO I PLAN FOR ILLIQUID ASSETS?

Illiquid assets, such as closely held businesses, private equity investments with lengthy lock-up periods and real estate, can make settling your estate difficult and can be accompanied by hard-to-pay estate tax bills. Illiquid assets can also make it difficult to equally distribute your estate among beneficiaries.

### **SOLUTION:**

Ensure there will be liquidity available to pay the estate tax bill on assets that are difficult to monetize or which your family may not want to monetize. There may be opportunities to defer the payment of estate tax bills on certain types of operating businesses. Carefully consider if other forms of liquidity, such as life insurance, could help cover expenses and make it easier to equally distribute your estate.



## MY CHARITABLE PROVISIONS ARE NO LONGER APPROPRIATE.

Similar to being surprised by the fiduciaries named in your documents, you may have forgotten that you named a specific charity as either a bequest recipient or an ultimate beneficiary under a “doomsday provision” (the ultimate takers of your assets if none of your beneficiaries survive you).

### **SOLUTION:**

Revisit your charitable intentions, and ensure your will and trusts are aligned with those goals. Make sure you provide guidance on beneficiary designations for Individual Retirement Accounts (IRAs) and other retirement assets. Also, consider setting up a family legacy charitable giving vehicle during your lifetime so contributions can be centralized and leveraged across generations.

## STRESS TESTING YOUR PLAN AT NORTHERN TRUST

To avoid unwelcome surprises, we find it helpful to conduct a stress test of your estate plan. The first step is to take a detailed inventory of your assets, broken down by how each asset is titled today (e.g., individual name, joint, trusts, etc.) and noting beneficiary designations where appropriate\*. To create this enhanced balance sheet, we categorize assets into five distinct buckets:

- **Liquid Assets**  
Assets that can be converted into cash in a short time, with little or no loss in value (e.g., cash, marketable securities, bonds)
- **Illiquid Assets**  
Assets that cannot easily be sold or exchanged for cash without a substantial loss in value (e.g., closely held businesses, private equity, real estate)
- **\*Deferred Assets**  
Income tax-deferred assets (e.g., deferred compensation, 401(k)s, IRAs and other retirement plans)
- **Liabilities**  
Legal obligations or debt owed to another person or company (e.g., mortgages)
- **\*Life Insurance**  
A benefit paid to your named beneficiaries by an insurance company upon your death

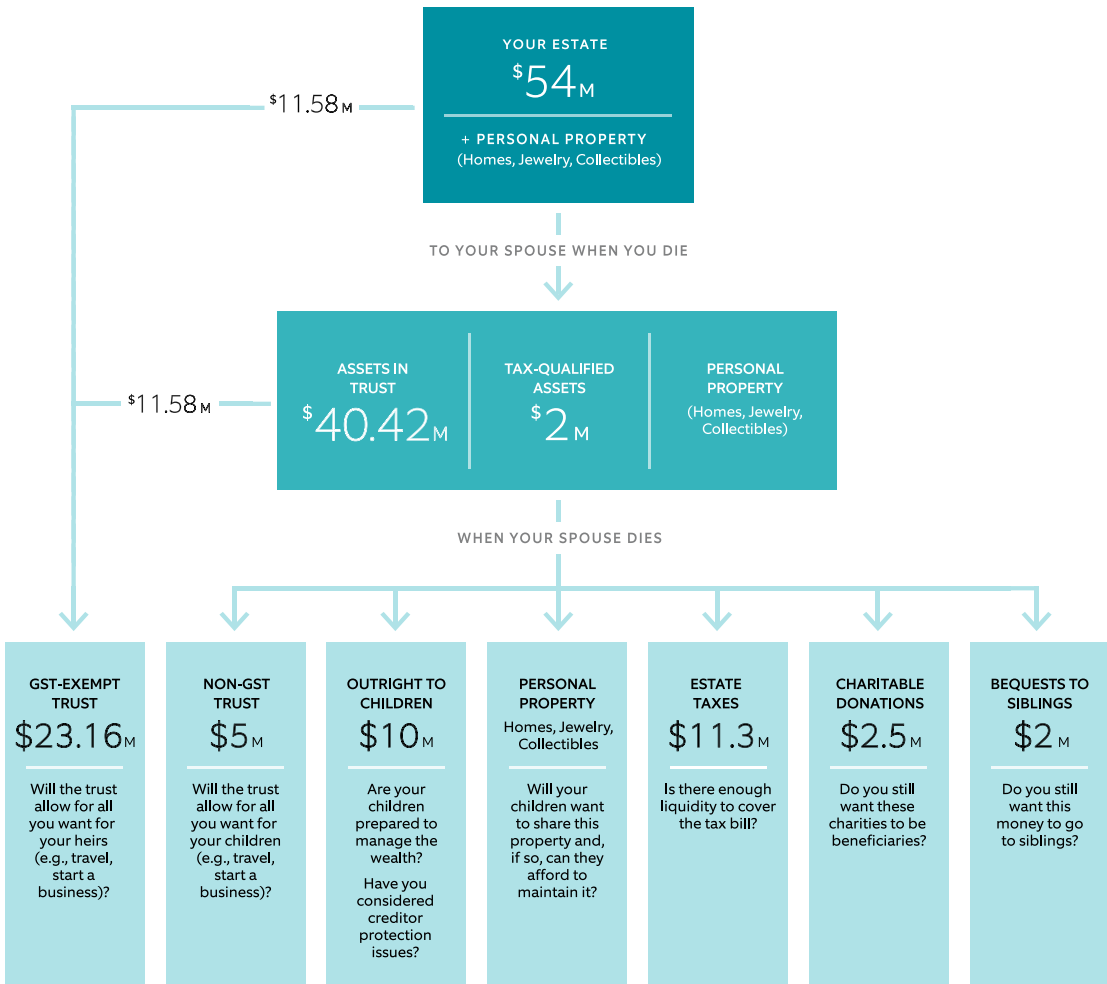
Once this framework is in place, we run all of your assets and liabilities through an estate plan flowchart, using the terms of your existing documents, to determine exactly how they will pass upon your death and at the death of your spouse. Some assets will pass by operation of law (such as joint tenancy assets), some by beneficiary designation (IRAs, life insurance), and others as directed in your will and/or revocable trust, which is why it's critical to get the titling right. It also is important to have a clear view of estimated federal and state estate taxes that will be due, if any. If you have done prior wealth transfer planning, and have assets that will not be included in your estate for estate tax purposes, we also model assets subject to estate tax (your taxable estate) and assets that will pass to beneficiaries free of additional estate taxes (outside your taxable estate).



Our estate plan modeling gives you a clear picture of what assets will pass to your beneficiaries, and importantly, the manner in which they will pass.

You will be able to quantify exactly what your beneficiaries will receive and evaluate if that amount aligns with what you hoped to transfer to your beneficiaries and/or charity. From there, you can revise and improve your plan to ensure that your lifetime, family and philanthropic goals will be fulfilled.

## ESTATE PLAN FLOWCHART AND CONSIDERATIONS



# DON'T LEAVE IT TO CHANCE

PRE-PLANNING IS THE KEY TO ENSURING YOUR ESTATE PLAN WILL ACCOMPLISH WHAT YOU WANT.

Digging in and paying attention to the details now will pay dividends well into the future by reducing future estate taxes, ensuring that your heirs will be able to use the money effectively and facilitating the settlement of your estate.

It is important to work collectively with a team of advisors – your estate planning attorney, wealth advisor, accountant, trust advisor, portfolio manager and estate administrator – to evaluate your full balance sheet and estate plan. This shared information will enhance each advisor's understanding of the total picture and result in a more efficient plan so that you can transfer your wealth with confidence and purpose.

When your advisors collaborate, strategies are better aligned, plans are executed more smoothly and you can achieve more with your wealth. Contact us to learn more about how we can work together to solve your most complex wealth challenges.

## ABOUT THE NORTHERN TRUST INSTITUTE

The Northern Trust Institute is dedicated to helping clients achieve more with their wealth through tailored strategies backed by research and innovation. More than 170 experts, representing diverse areas of expertise and geography, collaborate to analyze real-world client outcomes and harness the best ideas from working with wealthy individuals and families. The resulting insights enable the delivery of personalized advice to clients when they need it most.

## ABOUT NORTHERN TRUST

Northern Trust collaborates with clients and their advisors to offer holistic wealth management services for individuals and families, privately held businesses, family offices, and foundations and endowments. We are recognized for innovative technology, service excellence and depth of expertise across all aspects of financial planning, including wealth transfer, banking, insurance, investments, tax management, philanthropy, family communication and more.

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