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Anticipating and Minimizing Liquidity Needs

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What does it mean to anticipate and minimize liquidity needs?

Determine the value of your assets

The first step to anticipating the liquidity needs of your estate is to determine the value of your estate. This exercise may indicate that you are worth a lot more than you thought you were. You should include the value of everything you own: personal belongings, property, your business, life insurance policies, (including death benefits and cash value) cash and bank accounts, stocks, etc.

Anticipate final expenses

At your death, you can expect your family or estate to be faced with many expenses. There may be funeral and burial arrangements to pay for, which can run into thousands of dollars. You may have debt obligations to settle. Even if you have no outstanding loans or mortgages, there may be one final debt to settle--with the federal government in the form of estate taxes. Your state of residence (there may be more than one) will want in on the action, too. Estimating final expenses and comparing the result with your expected liquid resources should expose any gap that needs to be filled.

Engage in estate planning, which may include steps to minimize your estate's value

Estate planning is the process of assessing what you own, deciding how you would like it distributed at your death, and determining what the tax liability will be, if any. Once you have the groundwork set, you can actively manage your estate and take the proper steps to minimize the potential estate taxes that may be due. Don't think of estate planning as death planning; look at it as lifetime planning--an ongoing, evolutionary process that can change with your changing life circumstances.

Make preparations to cover cash liquidity needs at death

Once you have an idea of the value of your estate and the expenses that may be due at your death, you can plan how it should all be paid for. If estate taxes are owed, they will be due to the federal government within nine months after your death, in cash, and could total almost half of your estate's assets if your estate ends up in the highest tax bracket. Adding in other taxes and settlement costs can raise this to 75 percent. Your state may want death taxes even sooner than the federal government. Without advance planning, your family may not have the cash to make these payments. This could result in a forced liquidation of your assets to cover the tax liability.

The first step--surveying the territory

Business succession planning part of estate planning (not a substitute)

Business succession planning can be used to provide for an orderly transition of management and ownership of your business interests. If you have drafted a buy-sell agreement for your business that covers management and ownership transition after events such as disability, retirement, or death, you have taken a major step in the right direction. However, it is also very important that you take a look at your entire estate (all the stuff you own in addition to your business). Business succession planning is part of estate planning, just as your business is part of your estate.

What makes up your gross estate?

Basically, your gross estate comprises everything you own. Certain possessions may immediately come to mind (e.g., your business or your stock portfolio), but the list is actually more comprehensive.

Items in your gross estate may include:

- Cash
- Stocks, bonds
- Notes, mortgages
- Annuities
- Personal residence
- Other real estate
- Furniture, collectibles
- Automobiles
- Jewelry
- Retirement plan benefits
- Artwork
- Any other property or assets
- Partnerships, business interests
- Life insurance (including death benefits and cash value)

For more information, see Introduction to Estate Planning.

A simplified discussion of the net estate

Your adjusted gross estate is your gross estate less any debts. This value is further reduced by the value of assets passing to charity at your death and those assets passing to your surviving spouse under the unlimited marital deduction. The value after the marital and possibly other deductions is your net estate. If this value is greater than the \$2 million applicable exclusion amount, your estate will be subject to estate taxes.

For a more detailed explanation, see Estimating Estate Tax Liability.

The second step--projecting growth of your estate

Once you have determined a value for your estate today (and estimated your potential estate tax liability), you need to know what the value will be in the future--5, 10, 20, or 50 years from now. Chances are, the value of your estate will grow over time and with it your potential estate tax liability. This is especially true if you own a growing business that represents a large portion of your estate.

You may want to organize your estate to minimize potential estate taxes

Once you have the full view of what you own and how it could grow, you can develop your plan for what you want to happen to your estate when you die. Estate planning is an important function. Here is just a rough idea of what some of your options are for minimizing potential estate taxes. (Some of these can allow you to continue to enjoy control over your property until you are ready to fully let go.)

Tools in the Estate Planning Arsenal	
Technique	Benefit
Lifetime gifting	Can provide systematic reduction in size of estate and utilize the federal annual gift tax exclusion

Trusts	Many types of trusts for a variety of planning goals can be used to facilitate other methods
Estate freeze	Variety of tools under this category to prevent growth in the taxable value of your estate
What isn't taxed	Includes the applicable exclusion amount (formerly known as the unified credit) and the unlimited marital deduction
Post-mortem elections	Choice of alternative valuation date or installment payments of estate tax under Section 6166 can ease liquidity problem

Decide who gets what and when

When you develop your estate plan, you need to decide whom you want to receive your assets. You have the option of making lifetime gifts to beneficiaries or bequests at your death. There are definite tax consequences to this timing decision, and it is in your best interest to consider all your options. There are also tools available to assure the smooth distribution of your estate.

Planning for final expenses

What liquid resources are available today?

OK, so you've calculated the current value of your estate and made projections for the future. You know how you want your assets distributed. You also need to determine what resources will be available to pay for your final expenses and potential estate taxes. This is where you take a long, hard look at what you have for liquid resources--cash and assets that can be converted to cash quickly.

What resources will be available at your death?

You may have plenty of liquidity today to cover your current estimated final expenses and potential estate taxes, but are you sure you will have these resources indefinitely? Would you have to limit your lifestyle to maintain these resources, and would you want to do so?

Ways to pay for final expenses

There is more than one way to pay for your final expenses. One option is to hold cash. Another is to sell your property or assets.

Resource	Possible drawback
<ul style="list-style-type: none"> • Cash 	<ul style="list-style-type: none"> • Is there enough on hand? • Is holding cash for final expenses the best use of your money during your lifetime?
<ul style="list-style-type: none"> • Stocks, bonds 	<ul style="list-style-type: none"> • Will market conditions be favorable at time of sale?

<ul style="list-style-type: none"> • Real estate holdings 	<ul style="list-style-type: none"> • Could these holdings be sold at a fair price when needed? • Can a buyer be found in the time needed?
<ul style="list-style-type: none"> • Business interest 	<ul style="list-style-type: none"> • Will there be an available buyer? • Will the price be fair?
<ul style="list-style-type: none"> • Personal property 	<ul style="list-style-type: none"> • Will there be an available buyer? • Will the price be fair?

Life insurance may be a better way to pay

There is another solution to a liquidity problem. You could consider life insurance with a death benefit sufficient to cover your final expenses. Paying life insurance premiums represents a current expense, but the amount of your premium is generally quite small compared to the death benefit provided. Think of your premiums as a down payment on potential estate taxes and final expenses (sort of a layaway plan).

Tip: If it turns out that your estate doesn't need the money for expenses or taxes after all, then you have provided an additional asset to your beneficiaries.

Caution: Be careful when setting up the ownership of your life insurance. Insurance owned by you or your spouse is includable in your estate (thus compounding the problem), and there are certain tax consequences. You may want to consider establishing a trust or having your child or a sibling own the policy to keep it out of your estate.

See the discussion on life insurance policy types for more information.

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