

# Minimizing Estate Shrinkage

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## What is estate shrinkage?

When you die, you will leave behind all your worldly goods. Presumably, you will want these goods, called your estate, to go to your loved ones for their support, or to charity or other specific people, collectively called your beneficiaries. However, not all of your estate will actually go to your beneficiaries. There will be many hands looking for something. Some of your estate will go to pay your final expenses. Some of it will go to pay attorney's fees and probate costs. A lot of it may go to pay estate taxes. All of these costs must be paid first, before your estate can be closed and what's left can be distributed to your beneficiaries. In other words, the size of your estate shrinks before it actually gets into the hands of the ones it is truly meant for. If your estate shrinks too much, your family may not receive what they need for their support or your beneficiaries may not get what you intend for them to have. Being aware of and minimizing estate shrinkage is what estate planning is all about.

## What causes estate shrinkage?

The line that forms for your money after your death may be very long. What follows are the most obvious causes of estate shrinkage.

### ***Last illness expenses***

You may spend your final days in a hospital or other medical care facility. To the extent that they are not covered by insurance, expenses may be owed for room, board, inpatient care, medicine, and doctor's fees.

### ***Medicaid recovery***

The state may come looking for reimbursement for certain expenses it paid on your behalf under its Medicaid program.

### ***Funeral and burial expenses***

The cost of a funeral and burial these days can be thousands of dollars. These costs include fees paid to the funeral home and florist, for transportation, the burial plot, the monument, and eternal care.

### ***Debts and liabilities***

You will not only leave behind property when you die, you will probably also leave debts. Your creditors can make a claim against and are entitled to receive payment from your estate. Some of these debts may include mortgages, car loans, credit card accounts, and other loans or installment credit.

**Tip:** Creditors have a limited amount of time to file a claim against your probate estate (typically, one year). Your personal representative is given time to investigate the validity of and settle these claims.

### ***Estate administration expenses***

The total cost of administering your estate can be high (five percent of an average estate is not uncommon). This is especially true if assets need to be sold or your will is contested. Some common expenses include:

- Executor's or administrator's fees
- Cost of bonding your administrator, if required
- Attorney's fees
- Appraiser's fees

- Court costs
- Ancillary court costs, if you own property in more than one state
- Auctioneer's fees
- Brokerage fees
- Costs of insuring estate property while the estate is open
- Costs of maintaining estate property while the estate is open
- Accountant's fees

### ***Taxes***

As you may have guessed, taxes are the number one estate shrinkage factor. Here are the taxes for which you may need to plan:

- Unpaid property taxes
- Income tax on income earned during your last year of life (the tax should have been withheld)
- Tax on income earned by your estate
- Tax on income earned by any trusts included in your estate
- Federal gift and estate tax
- Federal generation-skipping transfer tax
- State death taxes, including generation-skipping transfer tax, and estate, inheritance, and credit estate taxes (sponge or "pickup" taxes)

## **Are there any hidden causes of estate shrinkage?**

Beware of the hidden causes of estate shrinkage. What follows are the most common.

### ***Incapacity***

Should incapacity strike and you are not prepared, your estate could be devastated. Planning for incapacity is a vital component of your estate plan.

### ***Lack of liquidity***

If there are not enough liquid funds in your estate to pay expenses when they come due, your personal representative may be forced to borrow at a high interest rate or sell assets to raise the cash quickly. Such a fire sale may result in an economic loss to your estate because the assets may have to be sold at bargain prices. Therefore, planning for liquidity is an important part of any estate plan.

### ***Defective estate plans***

Outdated or improperly executed wills or trusts or poorly arranged life insurance can cause estate depletion. Be sure you review and update your estate plan on a regular basis.

### ***Delay***

The longer it takes to settle and close your estate, the higher the cost. Expenses that increase over time include:

- Executor's or administrator's and attorney's fees

- Costs of insuring estate property
- Costs of maintaining estate property

Also, inflation can erode the value of the assets in the estate. Assuring the smooth transition of your estate now can help you avoid this consequence after your death.

### ***Bad timing***

There is no good time to die, but if your death occurs when the economy is depressed or inflation is on the rise, the estate shrinkage problem will be increased. Unfortunately, there are no recommendations to help you avert this situation except one--stay healthy.

## **What can you do to prevent estate shrinkage?**

Being aware of the estate shrinkage problem is a good first step in eliminating it. Then follow the next steps.

### ***Minimize estate taxes***

Because estate taxes may be the greatest estate shrinkage factor, you would be wise to make the most of the estate planning tools that can be used to minimize them. For example, you should understand and take advantage of allowable deductions and credits, implement estate freeze techniques, and plan for post-mortem elections.

### ***Plan for incapacity***

If incapacity strikes and you are not prepared, you may lose a large portion of your estate. There are many things you can do now to protect yourself against this event.

### ***Provide for estate liquidity and wealth replacement***

To keep your estate from having to sell assets in a forced sale or borrow at high rates of interest to meet estate expenses when they are due, you must plan now to ensure that the necessary liquidity will be present. Life insurance is probably the most common way to ensure sufficient liquidity and replace wealth lost to estate shrinkage factors.

### ***Review your plans***

Finally, review the plans you have made. Make sure that your estate planning tools--your will, trusts, forms of property ownership, life insurance, and so forth--will do the job.

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