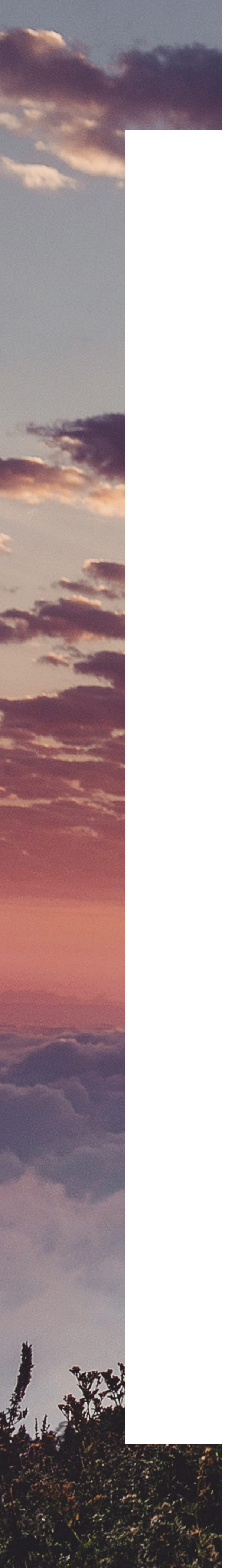
AB BERNSTEIN

Finding the Will

When "Simple" Strategies Fall Short



The well-known saying "Where there's a will, there's a way" suggests that motivation and determination can help overcome any obstacle. However, this adage takes on a new meaning in the context of estate planning. Indeed, a will (as in a last will and testament) remains key to providing for family members in a desirable manner—or at least, in a way that avoids needless hassle, tax exposure, and financial stress for surviving loved ones. But will any will do? When should you consider more complex estate planning strategies that go beyond the basics?

Avoiding Intestacy

To begin, let's revisit how property passes to a new owner at an individual's death. Specifically, property transfers at death in one of the following ways (**Display 1**):

- Assets owned with another person as "joint tenants with rights of survivorship" or as "tenants by the entirety" pass automatically to the surviving owner by operation of law.
- Assets with a completed beneficiary designation (for example, retirement accounts or life insurance) transfer automatically to the designated beneficiary.
- Assets held in trust (including a revocable trust) pass pursuant to the trust's terms.
- All other assets—that is, assets held in a decedent's sole name that do not have an accompanying beneficiary designation naming someone other than the decedent's estate—must pass to a new owner through the probate process (we will refer to these assets as "probate assets").

DISPLAY 1: HOW PROPERTY TRANSFERS AT DEATH

Automatically to Surviving Owner

- Assets owned with another as "joint tenants with rights of survivorship"
- Assets owned with another as "tenants by the entirety"

Automatically to Beneficiary

- Assets with a completed beneficiary designation (e.g., retirement accounts, life insurance)

Pursuant to Trust's Terms

- Assets held in trust (including a revocable trust)

Passes through Probate

- All other assets held in decedent's sole name that lack a beneficiary designation

Source: AB

Under the probate process, a court supervises the collection of a decedent's probate assets, payment of the estate's debts and expenses, and distribution of any remaining assets pursuant to the decedent's will—or, if there is no will, the relevant state's intestacy laws. Importantly, state intestacy laws differ greatly, with some states leaving a decedent's remaining probate assets entirely to a surviving spouse and others dividing up such assets between a surviving spouse and any surviving children. Thus, if a couple wishes to implement an "I love you" plan (that is, a plan under which the surviving spouse inherits all the deceased spouse's assets outright),[1] they may need to avoid the application of their state's intestacy laws. To do so, they would need to put the necessary estate planning documents—including a will and completed beneficiary designations—in place.

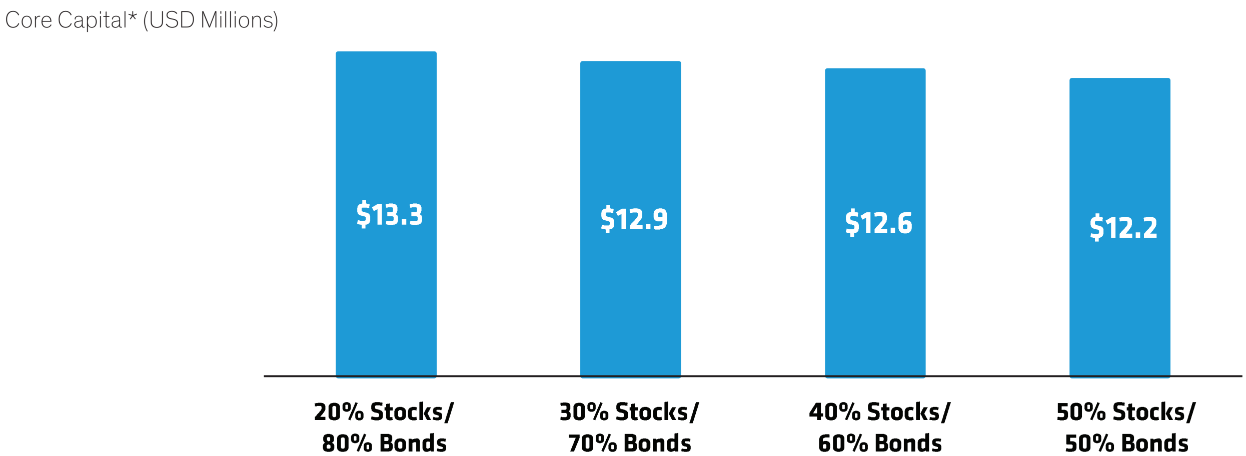
A Survivor's Surprise

Let's look at an example illustrating the importance of basic planning. Long-time Nashville residents Troy and Jackie were married for 55 years before Troy succumbed to an illness. Upon his passing, Troy left a $5 million IRA (naming Jackie as the beneficiary) and a $20 million brokerage account in his sole name. Notably, Troy did not have a will. For her part, Jackie owns a $5 million IRA. Under Tennessee's intestacy laws, Jackie and her two children, Charlotte and Matthew, will equally share Troy's brokerage account.[2] This leaves Jackie with $10 million in an IRA (including Troy's $5 million spousal rollover) and $6.67 million of Troy's brokerage account, for a total of $16.67 million.

To help Jackie better understand how Troy's passing impacts her financially, we start by analyzing her "core capital" needs. Core capital is the amount of money Jackie needs today to support her lifestyle for the remainder of her life—even accounting for potential poor market returns, high inflation, and an unexpectedly long lifespan. At age 80, Jackie estimates her lifestyle costs to be around $300,000 annually, plus another $100,000 per year for travel and visiting her children and grandchildren.

Based on our analysis, Jackie needs between $12.2 million and $13.3 million to fully fund her lifestyle, depending on how we invest her remaining assets (**Display 2**). The couple's holdings were allocated 50% in global stocks and 50% in bonds when Troy passed away. Keeping this allocation, we estimate a 19% chance that Jackie's portfolio will experience a peak-to-trough decline of 20% or more over her lifetime.

DISPLAY 2: HOW MUCH YOU NEED DEPENDS ON YOUR ALLOCATION



Probability of Peak-to-Trough Loss of 20%	<2%	3%	9%	19%

*Core capital was calculated at a 90% level of confidence assuming annual inflation-adjusted living expenses of $400,000.
The stock/bond allocations are assumed to be globally diversified stocks and intermediate-term bonds. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on the Bernstein Wealth Forecasting System℠ at the end of this document for further details.

1 Some would argue that a thoughtful and comprehensive estate plan can be an act of love, regardless of whether this includes an outright distribution to a surviving spouse.
2 Tennessee law allows for a spousal "elective share" that can entitle a surviving spouse to as much as 40% of a deceased spouse's probate estate, but this amount must be reduced by the value of assets passing to the surviving spouse, including those that pass outside of probate. Under these circumstances, Jackie would not be entitled to more than her intestate share due to her receipt of Troy's IRA.

On the other hand, if Jackie shifts her allocation to 20% global stocks and 80% bonds, the probability of a drawdown of this magnitude drops to less than 2%–while her core capital figure increases to $13.3 million. Despite the opportunity to de-risk, Jackie prefers the $1.1 million in "wiggle room" she enjoys with the lower core capital amount afforded by her current allocation. Plus, after years of living with a 50/50 allocation, she's grown accustomed to the ebbs and flows of the market.

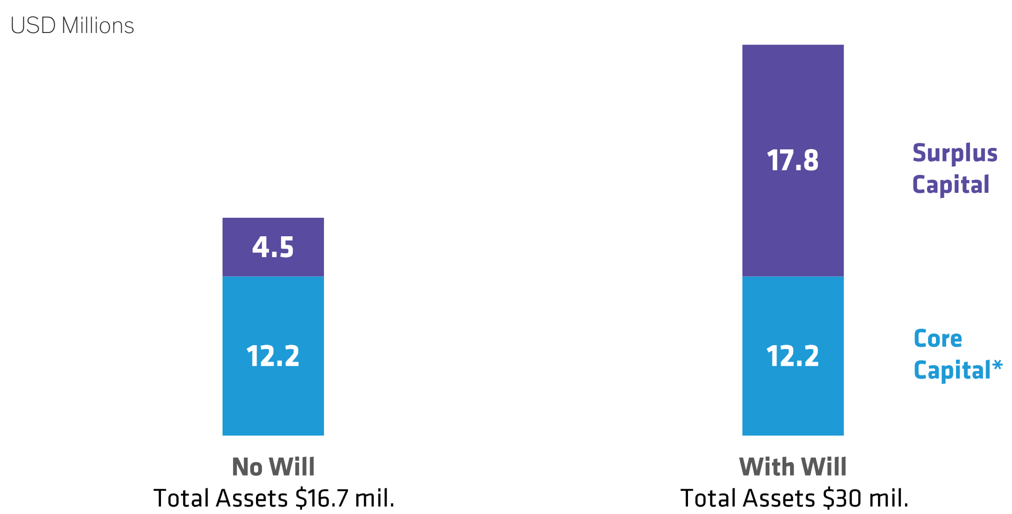
While Jackie is pleased that she still has everything she needs to support her financial goals—plus a little extra to spare—she remains frustrated. Something as simple as a basic will could have averted the unintended division of Troy's brokerage account. With a will naming her the sole recipient of the account, Jackie would have more "surplus" capital (assets not needed to support her lifetime spending needs) enabling her to make larger gifts to family or charity (**Display 3**).

A False Sense of Security?

Beyond avoiding intestacy, a thoughtful estate plan considers how assets should pass to designated beneficiaries—whether outright or in trust—and the tax implications of such transfers. Families with a large amount of accumulated wealth often find this planning component especially important, as it can significantly enhance the value of a beneficiary's after-tax inheritance. However, many individuals overlook this step due to the size of the recently increased federal estate tax exclusion amount.

As a reminder, current law allows individuals to give away up to $12.06 million, during life and/or at death, free of federal estate and gift tax. To the extent that the first spouse to pass does not use this entire exclusion, the surviving spouse may make a portability election on the deceased spouse's federal estate tax return. Doing so preserves the unused exclusion (referred to as the "Deceased Spousal Unused Exclusion Amount" or "DSUE amount") for the surviving spouse's later use. This approach frequently appeals to married couples because it requires less upfront planning, relying instead on the unlimited marital deduction[3] to avoid any tax liability at the first spouse's death. Additionally, assets held in the second spouse's taxable estate receive an income tax benefit, known as a "step-up," whereby the assets' cost basis is reset to the fair market value at the second spouse's death.

DISPLAY 3: RECEIVING ALL THE ASSETS CREATES ADDITIONAL SURPLUS CAPITAL... AND ADDITIONAL QUESTIONS



*Core capital was calculated at a 90% level of confidence assuming annual inflation-adjusted living expenses of $400,000.
Assets are assumed to be invested in 50% globally diversified stocks and 50% intermediate-term bonds. "No Will" assumes Jackie has $10 million of IRA assets (including Troy's spousal rollover) and $6.67 million of Troy's brokerage account. "With Will" assumes Jackie has $10 million of IRA assets (including Troy's spousal rollover) and all $20 million of Troy's brokerage account. Based on Bernstein's estimates of the range of returns for the applicable capital-markets over the periods analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on the Bernstein Wealth Forecasting System℠ at the end of this document for further details.

3 The unlimited marital deduction allows married couples to transfer assets to each other during life and at death without the imposition of gift or estate taxes. The receiving spouse must be a US citizen for the marital deduction to apply.

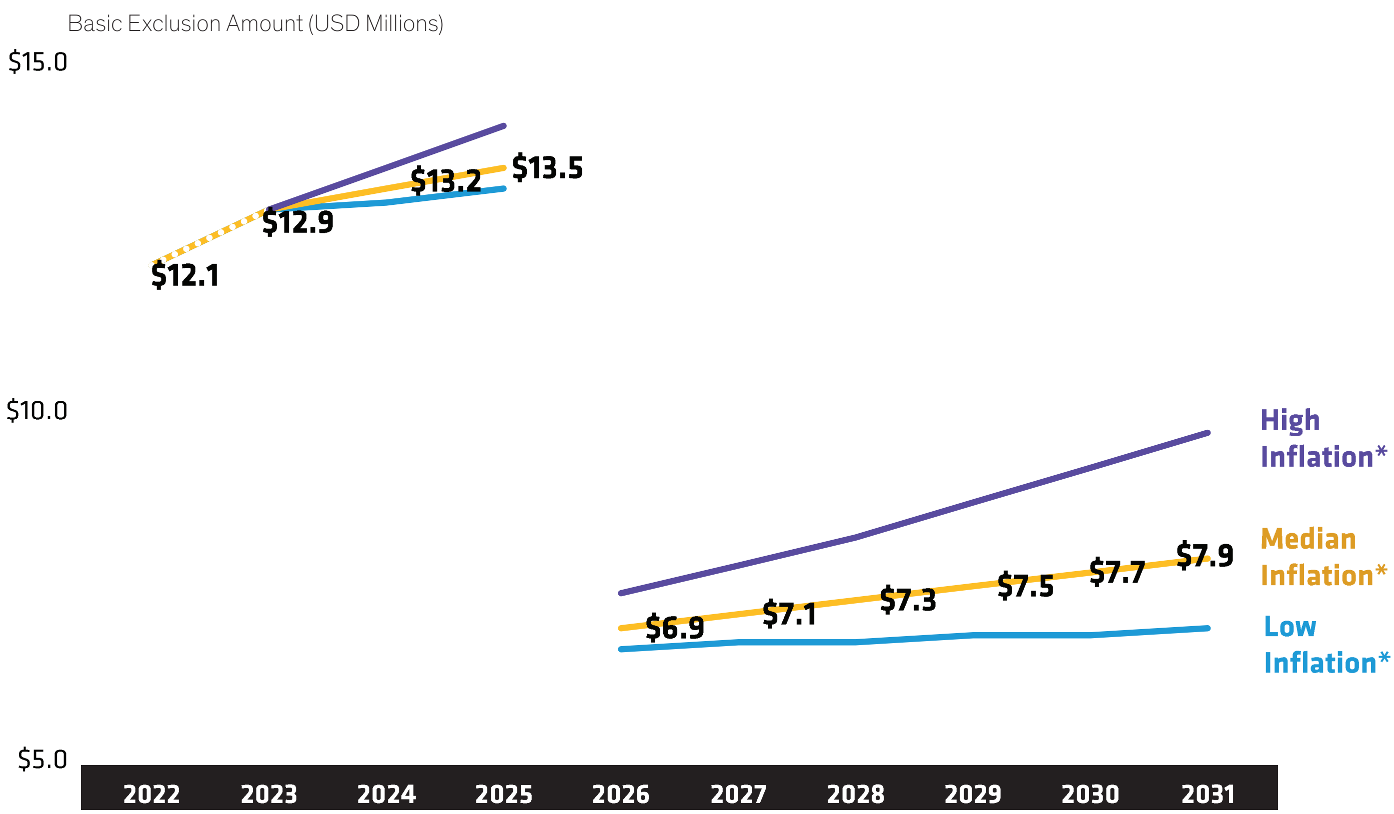
However, this strategy may be deceptively simple. Consider that the current federal exclusion amount will decrease by half in 2026 without congressional action (**Display 4**). That means couples relying on higher exclusion amounts to avoid estate tax may face a substantial tax liability instead. And, unlike the federal exclusion amount, the DSUE amount is not adjusted for inflation. If assets inherited on the first spouse's death appreciate, the DSUE may prove insufficient to sidestep an estate tax liability at the surviving spouse's death.

A Less Taxing Situation

Now, let's return to our couple to explore how an "I love you" plan might shape their tax strategies. This time, let's assume Troy left a will that directs his brokerage account to Jackie outright, leaving her $30 million in total assets after Troy's death. The unlimited marital deduction will defer, but not eliminate, the imposition of estate tax on Troy's assets. Ultimately, this will impose a 40% tax on the value of Jackie's taxable estate—including assets inherited from Troy and any appreciation over her remaining lifetime—to the extent this amount exceeds Jackie's remaining exclusion. Even though she could still leave a sizable inheritance to her children without further planning, Jackie wonders if there is any way to mitigate this tax.

To address her concerns, Jackie's estate planning counsel presents three options. First, Jackie could accept Troy's assets while electing portability on his federal estate tax return to preserve Troy's DSUE. This would eliminate any estate tax on this amount at Jackie's death.

DISPLAY 4: THE HEIGHTENED EXCLUSION AMOUNT WON'T LAST FOREVER



*Based on projected increases in "chained" CPI-U, rounded to the nearest $100,000 in this display. Basic exclusion amount is shown for an individual, based upon the 10th ("high"), 50th ("median"), and 90th ("low") percentile outcomes for the inflation-adjusted basic exclusion amount.
Based on Bernstein's estimates of the range of returns for the applicable capital markets. Data do not represent past performance and are not a promise of actual results or a range of results.
Source: AB

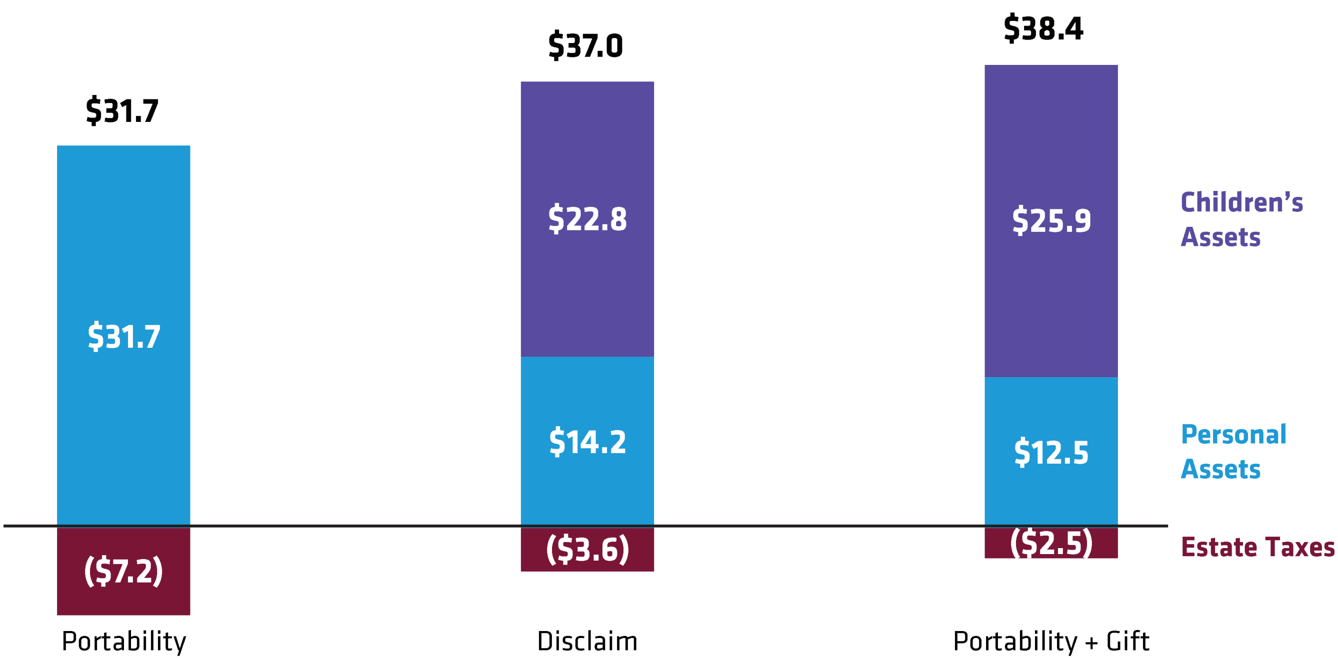
Based on our analysis, this approach leaves Jackie's family with an estate tax bill of $7.2 million at her death while transferring $31.7 million to her children along with a secondary step-up in basis, assuming Jackie lives for another 15 years (**Display 5**).

Second, Jackie could disclaim[4] $12.06 million of assets from Troy's estate, thereby redirecting the assets to Charlotte and Matthew as next-in-line beneficiaries. This option removes the disclaimed assets and their future appreciation from Jackie's taxable estate, which decreases her estate's federal tax liability to $3.6 million and increases the after-tax wealth passing to her children by $5.3 million (**Display 5**). However, disclaiming the assets means Jackie has no access to them during her lifetime. It also eliminates the second step-up in basis at her death. What's more, Charlotte and Matthew would receive the assets outright, leaving them exposed to potential creditors (including spouses) and triggering inclusion in their respective taxable estates down the road.

> Disclaiming the assets means Jackie has no access to them during her lifetime.

DISPLAY 5: DISCLAIMING ASSETS MAY NOT BE THE BEST STRATEGY

Year 15 Typical Markets* (USD Millions, Nominal)
After Estate Taxes†



*"Typical Markets" means 50th percentile results of 10,000 trials in our Wealth Forecasting System. Based on AB's estimates of the range of returns for the applicable capital market (as of December 31, 2021) over the next 15 years.

†In all scenarios, we have assumed the current estate tax exclusion will sunset. Thus, we have accounted for a remaining applicable exclusion amount of $6.03 million, for Jackie, adjusted with chained inflation and Troy's $12.06 million "DSUE" amount. Assumes marginal federal estate tax rate of 40% on assets in excess of the remaining exclusion amount.

Jackie's assets are assumed to be invested in 50% global stocks and 50% intermediate-term bonds. Children's assets are assumed to be invested in 70% global stocks and 30% intermediate-term bonds. Data do not represent past performance and are not a promise of actual future results or a range of future results. Asset values represent the estimated market value; if the assets were liquidated, additional capital gains or losses would be realized that are not reflected here. See Notes on the Bernstein Wealth Forecasting System℠ at the end of this document for further details.

4 A disclaimer must satisfy the requirements provided under § 2518 of the Internal Revenue Code to avoid being characterized as a taxable gift to the recipients. Relevant state law dictates what must be included in a disclaimer, to whom it should be delivered, and other details.

When Does a Disclaimer Make Sense?

Disclaimers can serve as useful tools for those looking to modify an existing (and otherwise irrevocable) estate plan. Faced with an unwanted inheritance, a potential inheritor may execute a written disclaimer to refuse all interests in the property. Then, the disclaimed inheritor will be treated as deceased for purposes of the decedent's estate plan, and the disclaimed property will pass to the next-in-line beneficiaries. If the disclaimer meets the requirements of a "qualified disclaimer" under IRC § 2518, the property will pass to the new inheritor without transfer tax consequences.

There are pros and cons to relying on a disclaimer. For instance, the disclaimer rules may prove too rigid for some. Consider that the potential inheritor must complete the disclaimer within nine months of the decedent's death. Such a momentous decision—especially during the grieving period—can be difficult to make in a short period of time. What's more, the person disclaiming the assets can't have any say in how the assets pass to others. The assets simply follow the distribution direction under the decedent's estate planning documents or, in the absence of any, the applicable state intestacy law. For example, a disclaiming spouse would be unable to direct assets passing to minor children into trust unless the decedent's estate planning documents stipulated as much.

In most instances, a disclaiming inheritor will also lose all access to the disclaimed assets. We should note, however, that the disclaimer rules provide a special exception under which a surviving spouse can retain access to disclaimed assets if the decedent's estate plan directs the assets back to such spouse or to a trust for such spouse's benefit, as we explore below. Thus, a disclaimer may provide flexibility for those willing to plan for its use.

Four Keys to an Effective Disclaimer

- The disclaiming person must make an irrevocable and unqualified refusal to accept an interest in the property
- The disclaiming person must not have accepted the interest or any of its benefits
- The interest must pass without any direction on the part of the disclaiming person
- The disclaimer must be in writing and be received by the transferor of the interest, or holder of legal title, within nine months

Jackie's third option involves accepting Troy's assets, electing portability on his federal estate tax return, then gifting $12.06 million to an irrevocable gift trust for her children's benefit. If she structures the trust as an "intentionally defective grantor trust" (IDGT) for income tax purposes, Jackie will be treated as the owner of the trust's assets solely for that purpose. This means Jackie can pay the trust's income tax liabilities during her life without such payments being deemed additional taxable gifts—and without inclusion of the trust's assets in her taxable estate. Minus the tax drag, the trust's assets can then grow at a faster rate while aiding Jackie in spending down her estate through yearly tax payments.

The IDGT option further reduces Jackie's estate tax liability to $2.5 million, thereby enhancing the after-tax wealth passing to Jackie's children by an additional $1.4 million (**Display 5**). Jackie could also wait to make this gift, if holding the assets for now gave her greater comfort. Unlike the disclaimer, which would need to occur within nine months of Troy's passing, she has time to make this decision. Also of note, the assets inside the trust would not receive the second step-up in basis (as previously mentioned).

> Failing to plan for today's complexities will not make them disappear.

Leave Your Options Open

Jackie breathes a sigh of relief when she sees that disclaimers and gifting can help reduce the estate tax owed at her death. But she is frustrated that she must decide between:

1. access to Troy's assets,
2. an additional step-up in basis, and
3. protecting her children's inheritance from creditors and additional tax after transfer.

Could the couple have taken additional steps to avoid putting Jackie in this difficult position? The answer, of course, is yes.

Rather than keeping things "simple," the pair could have left Troy's assets to Jackie in a qualified terminable interest property ("QTIP") trust, which qualifies for the estate tax marital deduction. This way, Jackie could have retained access to Troy's assets without triggering an estate tax liability at his death. Plus, she would have preserved a secondary step-up in basis at her passing. Alternatively, Troy could have directed that any assets that Jackie disclaims pass to a Disclaimer Trust benefiting both Jackie and their children. This would leave Jackie with the option to disclaim $12.06 million of assets out of her taxable estate—while still retaining access. Finally, they could have stipulated that at Jackie's death, assets transferred to their children through the QTIP Trust or the Disclaimer Trust do so via additional trusts, rather than directly. In effect, these advanced planning techniques would have rendered Jackie's subsequent decisions both less costly for the family and less perplexing for her.

Finally, the couple could have secured an additional tax benefit by building a QTIP Trust or Disclaimer Trust into their estate plan: the preservation of Troy's generation-skipping transfer ("GST") tax exemption. The GST tax applies at a 40% rate to gifts made to an individual (a "skip person") two or more generations below the gift giver, typically a grandchild or more remote descendant.[5]

Like the estate tax, every individual has an exemption from the GST tax equal to the federal exclusion amount. Unlike the estate tax, however, a surviving spouse may not preserve any unused GST tax exemption after the first spouse's death. This means Troy's family may only benefit from his remaining GST tax exemption if Troy's estate uses it by allocating the exemption to a trust or to property passing to a skip person. If Troy's assets pass outright to Jackie or her children under the planning options discussed above, Jackie would lose use of this exemption and potentially expose these assets to a 40% tax – a considerable bite. Had the couple established a QTIP trust or Disclaimer Trust, Jackie could have allocated Troy's remaining GST tax exemption to such trust assets, thereby preserving both her access to the assets and shielding them from GST tax in the future.

Foresight for Surviving Spouses

Planning your family's financial future involves considering your current assets, their potential for growth over time, and possible changes in tax laws and family circumstances. The sheer number of variables at play often makes a simple "I love you" plan sound tempting by comparison. But failing to plan for today's complexities will not make them disappear—and risks compounding them for the family members who are left behind. With the will to engage in thoughtful and comprehensive estate planning now, you can pave a better way forward for your loved ones.

5 The GST tax also applies to non-descendants who are 37.5 or more years younger than the transferor, subject to certain exceptions.

Notes on the Bernstein Wealth Forecasting System℠

The Bernstein Wealth Forecasting System℠ uses a Monte Carlo model that simulates 10,000 plausible paths of return for each asset class and inflation and produces a probability distribution of outcomes. The model does not draw randomly from a set of historical returns to produce estimates for the future. Instead, the forecasts: (1) are based on the building blocks of asset returns, such as inflation, yields, yield spreads, stock earnings, and price multiples; (2) incorporate the linkages that exist among the returns of various asset classes; (3) take into account current market conditions at the beginning of the analysis; and (4) factor in a reasonable degree of randomness and unpredictability. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market, and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results, or the actual probability that these results will be realized.

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