



3 Bullets a Simple Will Can't Dodge

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Plan ahead. 

Almost every client I meet truly thinks their situation is simple. They believe their estate plan should be easy to design and implement. Practically everyone wants a "simple" plan.

For most married couples, each spouse wants the surviving spouse to get all of their stuff when they die and then they want all their stuff to pass outright to their children in equal shares upon the death of the surviving spouse. This is a simple will.

You must understand that even if you have the most loving family and only an "average" estate, a simple will affords no protection against three common "bullets" that are likely to be fired at you and your family.

Bullet #1: Disability.

Although it seems obvious to some people, to others it comes as complete surprise that their will is only effective at their death. If you have a stroke or some kind of debilitating disease that makes it impossible for you to effectively manage your own property, your will does nothing to help. The fact that you have named your spouse or your very trustworthy, oldest child as the executor under your will is totally irrelevant.

If you are not able to handle your own affairs, someone else needs to be in place to manage your affairs for your benefit. A will is only effective at your death. If you are incapacitated and all you have is a simple will, your property may come under the control and supervision of a Court. This is commonly known as a guardianship. In a guardianship proceeding a probate Court will appoint a person to be the guardian of your estate. The guardian will take care of your affairs for your benefit. This is very costly and time consuming.

Your simple will offers no protection against the problems which will arise if you are disabled. There are a variety of things you can do before you are incapacitated to protect you and your family if this "bullet" is ever fired at you.

Some people think they have a bullet proof vest to protect against disability because they have joint accounts with their children. This is more like "the emperor's new clothes" than a bullet proof vest. While the child who is joint on an account may be able to transact business for you if you are later incapacitated, it can pose gift and estate tax issues that will be discussed later in this report.

There are two common and prudent ways to address disability planning when you have a "simple" situation.

A. You may execute a power of attorney that designates a trusted person as your agent to make business decisions for you if you are not able to make them for yourself, or

B. You may establish and fund a Revocable Living Trust that designates a trusted person to serve as a successor trustee when you are no longer able to serve as trustee.

Many times people will prepare a power of attorney to prevent problems from arising if they are later incapacitated. Unfortunately, third parties are not obligated to honor powers of attorney. It is not uncommon to see title companies, banks or brokerage houses refusing to honor a power of attorney either because it is in the "wrong" form or because it has been in existence for "too long" or because they can't be certain that you actually signed the power of attorney or they can't be certain you haven't revoked it. As a result, sometimes a power of attorney, although completely legal in the way it was executed, is not effective simply because the party who your agent is trying to deal with will not honor the power of attorney.

Plan ahead. 

A power of attorney may be an effective shield against the disability bullet, but you may not know for certain until it is too late. If you are using a power of attorney as your disability plan, you should contact the institutions where your assets are being held to determine if they will honor it and if they will not honor it, find out how it is defective and cure it.

The best and most comprehensive approach to addressing issues of disability is with a fully funded revocable living trust. By placing assets in a revocable living trust, you have changed the owner of the property from yourself to the trust. Typically, you will serve as trustee for as long as you are able and then, if you are incapacitated, a successor trustee whom you have designated would be able to handle the trust property for your benefit. The reason a fully funded revocable living trust is able to dodge the problems caused by the disability bullet is because the trustee holds legal title to the property. As a result third parties, such as title companies, banks and brokerage houses are obligated to honor the instructions of the trustee.

Bullet #2: The Law of Title.

The single most important factor in putting a successful estate plan together for you is how you hold title to your property.

For many people, the majority of their assets are controlled either by operation of law or beneficiary designations. That is they hold title to most of their property either as joint tenants with a right of survivorship with their spouse or a child, or the assets are controlled by a beneficiary designation. Typically, bank accounts and brokerage accounts are held as joint tenants with a right of survivorship and retirement plans, annuities and life insurance death benefits are controlled by beneficiary designations. Typically, none of these assets are controlled by the distribution provisions of a simple will.

Imagine how surprised you would be to find that you have an estate of over \$1,000,000 but your will only controls the distribution of a small fraction of your estate. Most clients I meet for the first time have very little property that is controlled by their wills regardless of the size of their estates. The reason is, most of their property is controlled by beneficiary designations and by joint tenancy with a right of survivorship. The Will has been hit with the bullet of the law of title and will be dead on arrival.

This can have devastating consequences. I have seen situations where one child is on all accounts with a surviving parent as a joint tenant with a right of survivorship. When the parent dies, the child who is joint on the accounts is the owner of everything in the accounts. You end up with a similar result if one child is designated as the beneficiary of all life insurance proceeds and retirement plans. The fact that the parent has a will directing that all property should be distributed equally between the children upon the death of the parent is irrelevant. The will has been rendered ineffective by the bullet of the law of title. To add insult to injury, putting the child on the accounts as a joint tenant with a right of survivorship creates potential gift and estate tax liabilities for the child and can cause serious conflicts in the family.

Some people prepare their own wills totally unaware that beneficiary designations and joint tenancy property are issues they should be concerned about. If that's not bad enough, attorneys who do not specialize in this area often make no inquires into these matters. This is a fatal mistake.

For most people I meet, controlling the disposition of their assets is not something they want to leave to chance. The whole purpose of their will is to get their property to their loved ones. A simple will does not control the disposition of your property that has beneficiary designations or property you hold a joint tenant with a right of survivorship.

How you hold title to property and your beneficiary designations should be carefully coordinated with your overall plan to insure that the right people end up with your estate at the right time and in the most appropriate way.

Bullet #3 Estate Taxes.

For married couples, a simple will appears to dodge the estate tax bullet. In reality, a simple will does not dodge the estate tax bullet, it puts married couples squarely in the line of fire.

Under current law, each person may leave \$675,000 (this amount is known as the "unified credit" and is scheduled to increase to \$1,000,000 by 2006) to anyone other than a spouse without incurring an estate tax. For a married couple then you would expect that they could pass up to \$1,350,000 this year to their children without incurring an estate tax. That is, both the husband and the wife would use their unified credit of \$675,000. Unfortunately, this is not the result with a simple will.

In addition to the unified credit, the Tax Code provides that you have an unlimited marital deduction. That is you may leave as much to your spouse as you want without incurring an estate tax. The unlimited marital deduction is an estate tax trap that puts your family squarely in the line of fire of the estate tax bullet if you have a simple will.

Under a simple will there would be no estate taxes at the death of the first spouse because everything would pass to the surviving spouse and since there is an unlimited marital deduction, no estate taxes would be due. However, when the surviving spouse passes away, he or she would only have one unified credit and could therefore only pass \$675,000 to the children.

To dodge the estate tax bullet, you need a tax oriented will or living trust. Here's how it works. At the death of the first spouse, the property of the first to die, up to the entire unified credit (\$675,000 in 2000 and scheduled to increase to \$1,000,000 by the year 2006) is placed in a trust. Typically, the primary beneficiary and trustee is the surviving spouse. At the death of the surviving spouse this trust terminates and the assets pass to the children. The assets in the trust are not considered the assets of the survivor for estate tax purposes. As a result both spouses may pass up to \$675,000 this year to their children without incurring an estate tax.

While it may be true that most estates are not large enough to warrant estate tax planning, the type of planning described above should be done for the majority of married couples for three other reasons. First, it allows the first to die to control all of his or her property and prevent it from ending up with a new spouse if the surviving spouse gets remarried. Second, it prevents the assets of the first to die from being spent down before the survivor qualifies for Medicaid. Third, it protects the assets of the first to die from the reach of creditors.