

Top Ten Myths and Misconceptions in Estate Planning and Administration

by Mary Beth Beattie, Esquire

The practice of estates and trusts law holds a unique place in the popular culture. People love to read about the will of a famous person or hear about the estate plan that went wrong leaving millions of dollars to be grabbed by the gold-digging spouse. Discussions on how best to bequeath one's wealth and how to control the wealth beyond the grave are the stuff of cocktail party chatter. Free seminars are offered on how to avoid probate and estate taxes. Hot tips on estate planning sell newspapers. Web sites tout do-it-yourself will kits. All this exposure to often incomplete or unreliable information has resulted in the popular view of estate planning and administration replete with myths and misconceptions concerning the process of estate planning, the laws involved, and their effect on a person's estate. While dozens of these myths and misconceptions abound, I offer the following as the "Top Ten."

1. Probate is always bad and must be avoided at all costs.

What is probate? Probate is the process by which, under the governance of the Register of Wills and the Orphan's Court, a decedent's property is marshaled, inventoried, sold, accounted for, and distributed according to the decedent's will or the intestacy laws. The property subject to probate consists of those assets which are titled in the decedent's name alone. Assets titled jointly, with right of survivorship, and assets passing by beneficiary designation bypass the probate process. These assets pass to the joint tenant or to the named beneficiary by operation of law.

Many clients believe that the probate process will necessarily result in a prolonged delay in the decedent's property becoming available to the personal representative to pay debts and expenses or otherwise manage the property. Frequently, clients relate horror stories of estate administrations which dragged on for years, believing the probate process is to blame. In truth, these instances often result from litigation of a matter involving the estate, difficulty in selling assets in the estate, lack of attention to the estate's administration, or mismanagement of the estate by the personal representative. Typically, a personal representative can be appointed within days of filing the petition for probate and other papers. The Letters of Administration which are issued to the personal representative can be used immediately to access funds for the management of property and payment of debts and expenses. Once the period for creditors to file claims has passed, no longer than six months from the date of death in Maryland, the personal representative may feel comfortable paying the specific bequests and making an advance distribution to the beneficiaries. Furthermore, Maryland now has a modified administration procedure for administration of those estates which can be completed within one year and meet other qualifications. Rather than filing an inventory and accounting, the personal representative who has elected modified administration files only a final report, drastically simplifying the probate procedure.

The probate mystique also includes the notion that probate is expensive. Certainly, probate can be expensive, especially if the decedent did not plan well for his demise. However, the most popular tool for avoiding the probate of a client's estate, the revocable trust, can be just as expensive to administer as an estate. An estate plan utilizing a revocable trust usually costs more up front than an estate plan with no trust, including higher legal fees for preparation of the trust agreement and fees and costs incurred in transferring property into the trust. After the decedent's death, most of the duties which a personal representative must perform during the probate process must also be completed by the trustee of the revocable trust. The trustee must appraise the property in the trust or hire appraisers to value the property, prepare an inventory of the property, account to the beneficiaries periodically for the income and gains and losses in the trust, and arrange for the preparation of fiduciary income tax and estate tax returns. The trustee must prepare deeds and other documents of transfer to distribute from the trust just as the personal representative must do to finally distribute the estate. The trustee of a revocable trust is often surprised to find that the estate plan designed to make his life easier after the decedent's death was no simpler than if the decedent had died with no revocable trust.

Moreover, the probate process has its advantages. First, the probate procedures and court oversight during the administration provide a well-defined procedure for the personal representative to follow. They also protect the beneficiaries from a personal representative who is negligent or self-serving, and provide a familiar and equitable forum for claims or objections to be heard. Most important to some clients, the short notice period cuts off the claims of creditors in a few months' time. In a trust, assets may be subject to a creditor's claim for the statute of limitations period applicable to the claim.

Clients often confuse bypassing the probate process with saving taxes. By associating probate with taxes, the client believes that the assets in his revocable trust will pass to his loved ones free of estate or inheritance tax, when this is not the case. Actually, the federal and the Maryland estate taxes, and to some extent, the Maryland inheritance tax, rely on principles having little to do with whether the property was subject to the probate process. Rather, the property included in the decedent's gross estate for tax purposes includes not only property titled in the decedent's own name, and hence, probate property, but also property over which the decedent had certain control during his life. Consequently, both probate and non-probate property may be subject to estate and inheritances taxes, and equating probate and taxes is a dangerous misconception.

2. Revocable trusts save estate taxes.

As previously stated, simply because an asset does not go through the probate process does not mean that it will not be taxed. Quite often, clients arrive at their attorney's office convinced by a speaker at a recent free seminar on "living trusts" that they must have revocable trusts to save estate taxes. While trusts are frequently used to minimize the impact of estate taxes, this type of estate tax planning can be implemented in a will or a revocable trust.

A typical estate plan for a married couple involves the creation of a trust, referred to in this article as a "bypass" trust, either in a will or in a trust agreement, which is designed to hold up to the applicable exclusion amount, formerly known as the unified credit, which is currently \$3.5 million. The remainder of the assets will typically pass to the surviving spouse outright or in a marital trust. This estate plan assures that no federal estate taxes will be due on the death of the first spouse to die and that federal estate taxes can be minimized or eliminated at the death of the surviving spouse. The exemption from Maryland estate taxes has been capped at \$1 million.

Often, the client is initially exposed to the concept of a revocable trust at a seminar or advertisement aimed at selling the revocable trust to everyone. The myth that the client must have a revocable trust to save taxes is a powerful selling point. In truth, the revocable trust itself saves no taxes. The part of the planning which affords the estate tax minimization is the inclusion of the bypass trust, which is designed to hold the applicable exclusion amount; and the bypass trust can be created in a will or in a revocable trust.

Of course, revocable trusts are useful in estate planning, and the estate planning attorney will explain the reasons for creating a revocable trust in detail to the client. If the client creates a revocable trust, by signing an agreement prepared by the estate planning attorney, any assets titled in the name of the trust will bypass the probate process at his death. In addition, if the client owns real property in jurisdictions other than Maryland, titling those properties in the name of the trust will obviate the need for ancillary probate proceedings in those jurisdictions. The revocable trust is an effective tool for disability planning and is often employed to hold the assets of an elderly person so that the trustee can manage her assets on her behalf. Finally, revocable trusts offer some privacy, as the trust agreement, unlike a will, does not become part of the public record after death.

3. Having a revocable trust means no probate.

Clients often mistakenly believe that having a revocable trust will itself guarantee a free pass around the probate process. In truth, only assets which have been titled in the name of the trust, or more accurately, the trustee, will be exempt from the probate process. Too often, estate planning attorneys find that,

although the decedent had a revocable trust agreement prepared for him during life, no one supervised the funding of the trust with the decedent's assets. The result is an empty trust, a probate of all the decedent's assets, and a useless estate plan. When an estate planning attorney discusses the option of a revocable trust with a client, she will list the advantages and disadvantages of the plan, including a description of the funding process and its costs. If the client opts for the plan, the retitling of assets into the trust, as an integral part of the plan, will be scheduled and overseen by the attorney.

Attorneys who do not practice regularly in the estates and trusts area can be instrumental in the trust funding process. When a client purchases real property or transfers investment property into an entity, the attorney can assure that if the client has a revocable trust intended to own all of his assets, these assets will also be held in the name of the trust.

Finally, even the client with a revocable trust needs a will. The estate plan will invariably include a pour-over will which provides, in essence, that any property remaining in the decedent's own name at the time of his death will be "poured over" to his revocable trust after passing through the probate process. Having a pour-over will maintains the integrity of the estate plan even if the client fails to transfer all of his assets to his revocable trust before his death.

4. My estate plan is simple—I just put all my property in joint names.

Many clients mistakenly believe that all their assets should be held jointly with another family member to simplify matters and avoid probate. The client often arrives in the attorney's office already having placed property in joint names, assuming that most of the planning is done. While property held jointly, with the right of survivorship, will avoid the probate process, and, in the case of a tenancy by the entirety, may provide creditor protection, other factors must be considered before deciding to place property in joint names.

In the case of married couples, jointly held property will often negate the planning commonly implemented to minimize estate taxes. As previously stated, a typical estate plan may include a will containing a marital gift to the spouse and a bypass trust which is designed to hold the applicable exclusion amount. However, only property in the decedent's own name will pass by the direction in his will. Jointly held property will pass outside the will to the surviving spouse, and will not be available to fund the bypass trust. If the couple does not have sufficient assets to fund the bypass trust, some or all of the decedent's applicable exclusion amount might be wasted. The final result of wasting the applicable exclusion amount in the estate of the first spouse to die is the inclusion in the surviving spouse's estate of more property than was anticipated, possibly giving rise to an estate tax.

Another common mistake is placing a child's name on assets, ostensibly to avoid the probate process and lessen the impact of the parent's death on the child's ability to access the property. In many cases, the client who does this is surprised to learn that she has made a taxable gift of one half of the value of the property to her child and that she may be required to file a gift tax return and may even owe gift taxes. She has also lost control of the property. For example, a woman who has added her son's name to the deed to her condominium cannot sell it without her son's consent and signature. This may be difficult to obtain if he disagrees with selling it or wants to hold out for a higher price. In addition, holding the property jointly with her son subjects it to the claims of his creditors. While his creditors may reach only his partial interest in the property, a lien may attach to the entire property, meaning that the mother can do nothing with her own condominium until she has satisfied her son's creditors.

More often than not, the parent actually has more than one child but has added only one child's name to the asset, usually for convenience, believing that the child holding the property jointly with the parent will share with the siblings after the parent's death. In reality, the parent may have disinherited the other children. A son owning a home jointly with his mother may know nothing of his mother's intent that he share with his siblings, or perhaps he knows her intent but ignores it. Even if he complies and shares with his siblings, he may be making a further taxable gift to them when passing the property along.

While owning property jointly is not always forbidden, the estate planning attorney will want to explore many factors with the client before recommending that property be held jointly, including creditor protection issues, exposure to estate and gift taxes, family dynamics, and disability planning.

5. I have less than \$3.5 million—I don't need estate planning.

The client's notion of the term "estate planning" is often closer to "tax planning" or even "financial planning" than to the estate planning attorney's meaning of the term. Many clients assume that if the total value of their estate falls under the amount of the federal applicable exclusion, currently \$3.5 million, they do not need an estate plan.

Estate planning attorneys use the term "estate planning" broadly, encompassing a wide range of analysis, advice, and document preparation, involving both tax and non-tax issues. The attorney will often focus first on the client's assets to determine if estate or gift tax planning is necessary. After analyzing the asset situation, the attorney may advise the client that his estate has, indeed, exceeded the estate tax applicable exclusion amount or will likely exceed that amount in the future, meaning that estate tax planning will be necessary.

Even if tax planning is clearly not the primary concern for the client, he may have other concerns that would be best addressed by preparation of a new will. For example, if the client has young children, the will can provide for their shares of the estate to be held in trust until they have completed their education and have matured to a responsible age. If the client has a disabled child or an elderly parent who will benefit from his estate, a special needs trust can be drafted into the will. The parent of minor children will want to nominate a guardian to care for the children until they reach the age of majority. In the will, the client may name contingent beneficiaries, personal representatives, and trustees. Without a will, most of these matters will be dictated by state law or handled in an open court proceeding, possibly causing results bearing no resemblance to the decedent's intent.

Analysis of the decedent's assets will also allow the estate planning attorney to address other issues the client may have. In smaller estates, where cash flow is often an issue, the attorney may suggest techniques to raise funds such as selling real property or purchasing life insurance. Clients with smaller estates are also likely to have placed many of their assets in joint names, further complicating their situation. The attorney must determine if holding property jointly is appropriate for the client, and if not, assist the client in regaining control of the property. The attorney will also discuss beneficiary designation on annuities, qualified retirement plans, individual retirement plans, and life insurance, to assure that these designations are in keeping with the client's overall estate plan. The estate planning attorney will also address disability concerns and typically recommend that the client give a trusted family member or professional a general power of attorney for financial matters and an advance directive for health care matters.

6. Life insurance is not included in the insured's estate.

Life insurance often composes a large portion of a client's estate. The client usually labors under the misapprehension that either the life insurance will not be included in his gross estate for estate tax purposes or that the cash or surrender value rather than the face amount of the life insurance will be included. This misconception may come from the erroneous notion that probate equals taxes. The flawed logic is that if the life insurance proceeds pass to the named beneficiary and do not pass through the probate process, then the proceeds must not be taxable for estate tax purposes. Also, the income tax exempt nature of life insurance may cause confusion about estate taxation.

Young couples who are just starting their families need large amounts of life insurance, which can usually be purchased at a relatively low cost. These clients concern themselves with educating their children and replacing lost earnings should a parent die at a young age. While these families typically have little in the way of accumulated wealth, one or more large life insurance policies can easily advance the value of the couple's estate over the applicable exclusion amount.

Depending on the size of the life insurance policy as well as the value of the other assets in the couple's estate and the potential growth in the estate from savings, retirement plans, and investment appreciation, the value of the policy may be sheltered by the applicable exclusion amount and can be worked into the estate plan by naming the bypass trust as the beneficiary of the life insurance. However, if the life insurance policy will likely expose the estate to taxation, the estate planning attorney may suggest that the insurance be assigned to an irrevocable life insurance trust. The life insurance trust will hold the insurance policy during the life of the insured, and at the death of the insured the proceeds will be paid to the trust. The trustee of the trust may use the proceeds to purchase assets from the insured's estate to provide liquidity to pay expenses, debts, or taxes. Properly drafted, funded, and managed, the life insurance trust can remove the value of the policy from the insured's gross estate. If an existing policy is transferred to the trust, the insured must survive for three years or the value of the policy will be includible in his estate. Preferably, the attorney will prepare the trust agreement prior to the purchase of the policy, allowing the trustee to purchase the policy at the outset and eliminating the three-year survival requirement.

7. My will is done—I'm all finished.

The client, satisfied with the will she has just signed, thinks the estate planning is complete. In truth, proper asset titling and beneficiary designation can be as important to the estate plan as the will itself. For example, if the will includes typical estate tax planning for a married couple, with a bypass trust designed to hold the applicable exclusion amount, then the couple's assets must be titled to assure that the bypass trust will be funded. As previously stated, jointly held property will pass by operation of law, making it unavailable to fund the bypass trust. The estate planning attorney will typically recommend dividing the couple's assets so that they are holding the property as tenants in common or so that each spouse holds property in his or her own name. The property held as tenants in common or in the client's sole name will pass through the will and will be available to fund the bypass trust. In addition, the attorney will review those assets which pass by beneficiary designation, such as life insurance, to determine if the designations coincide with the rest of the couple's estate plan.

The client's IRAs, retirement plans, and annuities should also be reviewed. In some instances, the plans themselves contain terms or restrictions which affect the method of payout permitted to a beneficiary or which restrict how the beneficiary is designated. The attorney will review the beneficiary designations and recommend any necessary changes. If the client's IRA may be needed to fund his applicable exclusion amount, he may be advised to name his spouse as the primary beneficiary to allow for the income tax advantageous rollover permitted to spouses. He may also be advised to name the bypass trust as the contingent beneficiary so that the spouse may continue to receive the IRA payments through the trust while sheltering the value of the IRA from estate tax. Clients often overlook their IRAs and other retirement plans when thinking about their estate plan. A client may execute his will leaving his estate to his minor children in trust until age 30, while his IRA, now worth over \$2 million, names the children in equal shares. This designation will necessitate a guardianship for each child with the child receiving the property outright at age 18. Clients should also be aware that IRA custodians such as brokers and financial institutions are inflexible in accepting beneficiary designations from account holders, wreaking havoc on most estate plans where the IRA proceeds must be paid to the beneficiaries in trust or where more than one level of contingent beneficiaries must be named. Careful attention to retirement accounts and their beneficiary designations is vital to provide the client with a complete and coordinated estate plan.

8. I thought the estate tax had been repealed.

Many clients are surprised to hear that although the repeal of the federal estate tax was widely discussed in the news and touted by the federal administration, the estate tax is not scheduled for repeal until the year 2010. Beginning in 2001, the year the law took effect, until this year, the transfer tax system changed virtually every year. The applicable exclusion gradually increased to the current level of \$3.5 million, while the lifetime exemption from the gift tax remained at \$1 million. Estate tax rates decreased gradually

and are now at a flat rate of 45%. The state death tax credit was converted to a deduction. As a result, many states, including Maryland, enacted state estates tax systems which are decoupled from the federal estate tax system. To make matters more interesting, the estate tax and the generation-skipping transfer tax, but not the gift tax, are repealed in 2010 for only one year. In 2011, the entire system returns to the law in force in 2001. And that's just some of it. In 2010, the step-up in basis, which applies to assets included in the gross estate of a decedent and essentially wipes out all unrealized capital gains in those assets, will also be repealed and replaced by carryover basis. The loss of the step-up in basis and the reintroduction of carryover basis means that the client will need to keep copious records of all purchases of property, including stocks and bonds, so that the cost basis can later be used to determine the basis of the property. The full effect of carryover basis may not be clear to the client until a family member dies and the client becomes responsible for piecing together the purchase records for a large stock portfolio containing securities purchased many years ago that have split many times, incurred spinoffs, and undergone name changes.

The changes in the transfer tax law are almost too numerous to explain to each new client, and as the picture changes virtually every year for the next several years, estate planning can be frustrating and arduous. The client, having heard that estate taxes were repealed, has difficulty grasping these myriad changes. Unfortunately, until Congress changes the transfer tax laws again, estate planning attorneys and their clients will be struggling to formulate estate plans which both meet the client's goals and provide some element of predictability.

9. Our son should be our attorney-in-fact. He lives with us and doesn't have a job, so he has time to help us.

One of the most difficult decisions a client must make when preparing an estate plan is naming fiduciaries to manage the client's assets in the event of death or disability. Parents typically name one or more of their children as fiduciary, meaning personal representative, trustee, or attorney-in-fact, but as the heading for this section indicates, many clients make the mistake of appointing as fiduciary a child who is completely inappropriate. Not all children have the background to properly carry out the duties of a personal representative or trustee; the position requires some experience managing assets as well as an understanding of the process involved in administering an estate or trust. Some children do not have the parents' best interests at heart and, when given unlimited power of appointment over the parents' assets, may be tempted to use them for their own benefit. Clients often want to name all of their children as fiduciaries to avoid conflict among them or to avoid hurting a child's feelings, but by involving more personalities in the decision making, they may be setting the stage for even greater conflict. Even when they don't conflict, fiduciaries working in groups larger than two often find the arrangement to be cumbersome.

While clients will continue to name family members as fiduciaries, and a good many of these family members will be appropriate choices, the estate planning attorney will usually discuss the advantages of naming a corporate or professional fiduciary, especially with those clients who cannot find suitable candidates within their families. Clients typically enter the estate planning process with a preconceived notion that corporate and professional fiduciaries are expensive and should be appointed only as a last resort. Of course, corporate and professional fiduciaries are permitted to charge fees that are likely to exceed those allowed individual fiduciaries under the Maryland law. However, corporate and professional fiduciaries are equipped with the necessary experience in preparing accountings and tax returns, reviewing trust agreements and wills, investing assets, and dealing with the laws which govern the administration of estates and trusts. Appointing a child as fiduciary who later mismanages the estate, alienates the beneficiaries, and causes financial losses through negligence and inattention can prove to be even more costly. In addition, by taking on the responsibility of administering an estate or a trust, a fiduciary exposes himself to liability for breaches of duty and negligence. Naming a corporate or professional fiduciary relieves the family members of this exposure.

A corporate or professional fiduciary is not the best choice in every estate plan and will not be the choice of most clients. When a client decides to name a family member as fiduciary, the attorney may suggest

that the family member serve as fiduciary with a corporate or professional fiduciary or will discuss the need for the family attorney and accountant to stay involved in the administration process to assist the family member in carrying out his duties.

10. All I need is a simple will.

Perhaps more than any other myth in the book, “All I need is a simple will” is the most common. Estate planning attorneys hear this every day. The truth is that there is no such thing as a simple will, or certainly not a simple estate plan. Even the client with the most straightforward of estate plans, such as a single parent with one child, no grandchildren, and a modest estate under \$3.5 million may have issues to discuss and resolve that she doesn’t expect. She may have added her child’s name to her real property, exposing it to the claims of her child’s creditors. If her child is disabled, she will want to consider including a special needs trust in her will. If her elderly father lives with her and she intends to leave him part of the estate, she may decide to create a discretionary trust for his benefit and name a trustee to manage the trust funds. She will need to change the beneficiary designation on her retirement plans which still name her deceased husband as the sole beneficiary. Perhaps she has serious health issues and needs a revocable trust or a power of attorney to manage assets.

Young couples are often mistaken about how simple their estate planning will be. They have not considered before meeting with the estate planning attorney that they will need trusts for their minor children and that the trusts must have a trustee to manage the assets for the children until they are out of college or longer. Clients with children from prior marriages present a particularly challenging estate planning situation, but they routinely expect their estate plan to be simple. For example, the couple has decided on a plan for the children of both marriages, but they want to keep it simple and hold all property in both names jointly. They are surprised to hear that the surviving spouse may change the plan after the death of the first spouse to die, unless trusts are created to hold the property and assets are titled properly to fund the trusts. The attorney may suggest that the couple have a postnuptial agreement prepared prior to the estate planning so that the decisions they make with regard to their property will have the force of contract. Estate planning for these couples can become quite complicated and awkward. It is anything but simple.

Conclusion

These days, when many people think of professional services as commodities, clients often believe, paradoxically, that although each client’s situation is unique, all their myriad issues and problems can be solved with a standardized product. Thus, while many clients approach estate planning with the attitude that theirs is a simple matter, and that their attorney can present a product to them which will solve all their problems easily, conveniently, and cheaply, the truth is that estate planning and administration properly handled is a complex and involved process for nearly every client.