The Legal Intelligencer

Top 10 Estate Planning Mistakes We See and How to Avoid Them

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By **Rebecca Rosenberger Smolen and Amy Neifeld Shkedy** | September 06, 2018

Rebecca Rosenberger Smolen, left, and Amy Neifeld Shkedy, right, of Bala Law Group.

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Joint Accounts. We often learn, after a client's death, that the client had been persuaded, by a friend, family member, or bank teller, to add a child's name to a bank account (or even an investment account or real estate) in order to make things easier to access the client's funds after death, for the purpose of paying funeral and other bills, and distributing funds to heirs. As a general matter, we advise against this practice because it muddies the water about the client's intentions for those funds.

Under Pennsylvania law, the presumption would be that the funds in a joint account belong to the surviving party named on the jointly titled assets. First of all, that might mean that the client's intentions would be thwarted if the client expected that his or her Will would govern the asset. Second, the joint owner's creditors might be able to access the client's asset. Third, if there is an unnatural order of deaths, and the joint owner dies before the client, there would be a Pennsylvania inheritance tax on half of the assets.

The better course of action would be to have a power of attorney registered for the account so that a trusted person can access the funds, if necessary, for the benefit of client in the event of incapacity. After the client dies, creditors (including a funeral home) can wait a few weeks until the probate process is initiated to be paid, or, the client's heirs can find a way to advance the funds and be repaid from the client's estate once it is raised. Also, clients may elect to set up prepaid funeral plans with various cemeteries and funeral homes to avoid the need for an heir advance the funds for such purpose.

I Love You Wills. With the federal estate tax exemption at the historically high level of more than $11 million (compared to $600,000 in the 1990s), and the advent of the "portability" mechanism for a client's unused exemption at death, many folks are concluding to keep their estate planning "simple" and just leave all of their assets outright to the surviving spouse on death.

Although the federal estate tax exemption is portable, it's important to be mindful that the exemption from the federal generation skipping transfer (GST) tax is NOT portable. So, if all assets are left to the surviving spouse, the GST exemption available to the first spouse to die will be wasted. Perhaps, GST planning is less of an issue for most families currently because of the high estate tax exemptions, but, for some it is still an issue, and for others it will become an issue if the estate tax exemptions decrease in the future when the political balances shift down the road in Washington, D.C.

Besides the tax issues, whether a client is married to the parent of his or her children or not, a client generally is ultimately motivated to leave the fruits of his or her labor to the next generation to the extent the surviving spouse will not need them for his or her support. Some clients really don't care about who ultimately benefits from their assets, but most do care. By leaving the assets to the surviving spouse, the first spouse to die loses control of who will ultimately benefit from his or her assets after both spouses have passed. In our experience, the best way to address this issue is to establish a trust with a good portion of the assets attributable to the first spouse to die, so that there will be a direct legacy from the first spouse to die to the objects of his or her bounty (other than the surviving spouse), to the extent that the surviving spouse will not need all of the assets for his or her support.

Receiving an Inheritance Outright. We have had clients receive significant inheritances in their own names, rather than in trust, and then turn around and try to get the inherited assets off of their personal balance sheets for one reason or another. Sometimes it's for Medicaid planning purposes, and sometimes it's because the inherited funds are "gravy" that they don't want or need. It's better to plan ahead and receive the funds in a trust structure so that they can keep the assets available as a "safety net" or allow the assets to benefit other family members as "co-beneficiaries" rather than need to use their own federal gift tax exemption to benefit other family members. Also, for clients with creditor issues, it's essential to receive the assets in trust to avoid having them be applied to satisfy creditors' claims.

Failing to Update Beneficiary Designations. Many assets do not pass under the terms of a Will at death, but, rather pass in accordance with beneficiary designation forms completed by the client during his or her lifetime. We have had clients die more than 20 years after being married with children and never update their beneficiary designations that had been completed to benefit siblings and nieces and nephews before the marriage. We have laws protecting "pretermitted spouses and children" who weren't covered in wills written before marriage/birth, but, not for beneficiary designation forms completed before marriage/birth. Under those circumstances, the spouse and children will either be deprived of funds the client would have wanted them to receive, or, they will need to rely on the good graces of the named beneficiaries to either gift the assets to them or disclaim their interests in the assets.

Naming an Estate as Beneficiary of an IRA or Qualified Retirement Plan Benefit. There have been proposals in Congress to eliminate the problems associated with naming an "estate" as beneficiary for IRAs or other qualified retirement plans, but, to date, the problems still persist. Many folks naturally think that the most efficient way to proceed with naming a beneficiary is to designate their estates since up until the time of their deaths they can update a Will to change how their estate assets will pass when they die. Our preference is to generally afford clients this flexibility by naming a revocable trust as beneficiary instead. Under current law, if an "estate" is named as beneficiary, rather than individuals or a properly drafted revocable trust, under the current “minimum distribution rules,” the number of years over which the tax deferred account can continue for the benefit of a client’s heirs will usually be sharply reduced.

Failing to Title Out of State Real Estate to a Revocable Trust. Many clients own vacation residences in other states. An ancillary probate can be avoided in the other state if the real estate is owned by a client’s revocable trust, rather than in the client’s name. While an ancillary probate may not be a “big deal” in many states, in others, it can be a significant cost and hassle. In our experience, an ancillary probate in New Jersey is generally not worth avoiding, but, one in New York, Florida and California should be avoided if possible.

Not Considering a Roth IRA Conversion. For clients who will not use all of their IRA funds during their lifetimes, it is worthwhile to consider converting all or part of them to Roths to allow both themselves and their heirs to benefit from the tax free compounding. This can be a particularly attractive option for clients upon retirement during years when they hit lower tax brackets, since they can convert a portion of their IRA to use up the lower brackets each year. It can also be beneficial to clients whose estates will be subject to the federal estate tax since the income tax paid will reduce their taxable estates. It’s certainly a better choice to convert to a Roth IRA than to withdraw the IRA assets prior to death to trigger the income tax for this purpose (as we have seen at least one decedent be advised to do as a last minute tax planning move).

Delaying Large Charitable Gifts Until Death. As a general matter, it is better for clients to make significant gifts to charity during their lifetimes rather than wait until their deaths. First of all, by waiting until death a client generally loses the opportunity to take advantage of the income tax benefit that would likely be available for an inter vivos gift. Second, the client loses the opportunity to steward the gift and help ensure it is used for the purposes intended by the client. For clients who are uninterested in the stewardship opportunity, but care about securing tax benefits, they can consider charitable remainder trusts or charitable gift annuities which allow them to benefit from a current income tax deduction for assets that the charity will not receive until death. There is also an opportunity to do the reverse through a charitable lead trust—there are federal gift tax savings opportunities for a trust that makes payments to charity on the front end, and then after a term of years, or on the client's death, the trust remainder passes to noncharitable objects of the client's bounty.

Gifting Highly Appreciated Assets During Lifetime. Because of the basis-step up opportunity at death (for capital gains tax purposes), it is often best to gift cash or high basis assets during lifetime and hold on to highly appreciated assets (with low basis) until death. This allows heirs to avoid paying capital gains tax on the built in gain of the highly appreciated asset.

Failure to Create an Estate Plan. Of course, the number one mistake is not creating an estate plan at all. As we've heard financial planners say before, failing to plan is planning to fail. Although there are mechanisms in place under state law to transfer assets to heirs (i.e., next of kin) without a will, that is not often the plan decedents would have selected if they gave it more serious consideration.

Creating an estate plan, at its essence, involves deciding and legally documenting who gets what and who should be in charge. As a secondary matter, decisions are made about how the inherited assets will be conveyed, such as whether a trust should be used and, if so, how it should be structured. Estate planning also involves planning for potential incapacity before death by creating a general power of attorney, health care power of attorney, and advanced directives for health care. For someone who becomes incapacitated without an effective general power of attorney in place, a costly and time consuming court supervised guardianship process will likely need to be pursued.

We believe EVERYONE should have an estate plan. Neither the cost nor the expenditure of time should be a deterrent. The cost is less than what many folks spend on cable TV or car insurance each year, and is far less than the annual cost of health insurance. The time commitment, for a majority of clients, involves a one-hour meeting to discuss the appropriate plan, and then another meeting for less than an hour to sign the documents. That is probably less time than most folks spend visiting the doctor or dentist each year, and without the same waiting room time, or same need to plan for a return visit each subsequent year.

In reality, we have observed that creating an estate plan is practically (if not) the last, rather than anywhere near the first, item on most folks to do list, if it even makes the list at all. While we recognize it may not be a “fun” and enticing project, and may seem less time sensitive than other tasks on the list, it truly should be considered worthwhile to elevate its priority since it could easily have a much earlier than expected deadline (no pun intended).

Rebecca Rosenberger Smolen *and* **Amy Neifeld Shkedy** *are members and co-founders of Bala Law Group. They focus their practices on tax and estate planning.*