

Wills, Intestacy, and Testamentary Planning

Dying without a will can create serious legal and financial complications for your clients' families. This course examines the consequences of intestacy and walks through how a well-drafted will can put clients in control of their legacy. You'll explore testamentary planning techniques, the role of trustees, and important drafting considerations—including cautions around trustee removal language. A solid refresher for any professional involved in estate planning or working with clients who have yet to formalize their wishes.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recognize characteristics of the probate process.
- Recall the duties of a trustee.

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Chapter 1: YOU DON'T HAVE A WILL? BIG TROUBLE!

Chapter Objective

After completing this chapter, you should be able to:

- Recognize characteristics of the probate process.

There's no way to get around it. Thinking about death is downright depressing. The emotional burdens of merely considering it can easily overshadow any financial or legal planning. However, not writing your will and failing to do even the most basic estate planning can have disastrous effects on your loved ones and other survivors.

Let's take a closer look at how property is transferred to your heirs if you die without a will. If you die without a will, you are said to die *intestate*. In essence, you have delegated your last wishes to your state legislators. Your unwritten will reads something like this:

I, being of sound mind, do hereby direct that the legislators of my state handle my estate as follows:

The state may appoint my surviving spouse as the administrator of my estate, or, in its infinite wisdom, the state may appoint someone completely unknown to my family.

My administrator will be required to post (an expensive) bond to provide "insurance" in case he or she is incompetent as my estate representative.

My surviving spouse is to receive one half of my estate. The other half is to go to my three-year-old daughter.

Since my child is a minor, the state may choose my surviving spouse or someone unknown to my family to act as "conservator" to manage my child's assets. In either case, another (expensive) bond must be purchased annually and the conservator must periodically appear before the court (more fees) to provide an accounting of how my child's assets have been used. I understand that the court can be pretty picky about how money is spent. If the court disagrees with how my conservator has spent money, then my conservator can be held legally liable.

When my daughter reaches the age of majority (age 18 or 19 in most states), she will receive her inheritance outright, and I am going to assume that she is mature enough to handle the money in a manner that would make me proud.

If for some reason my spouse does not survive me (common accident?), I ask the state to decide who would be the best person (or institution) to raise my child. I hope they don't choose my Aunt Thelma!

If my surviving spouse remarries and then has the misfortune to predecease her new husband, it's okay that the assets I left her may go to him and not to my daughter.

I am happy to pay, from the proceeds of my estate, expensive legal, court, and administrative fees.

Finally, I realize that my poor planning may create large estate taxes that could have been avoided if I hadn't been so darn lazy.

Signed,

Your Loving but Procrastinating Husband

We hope you find this will unacceptable. The intestate laws of each state vary widely.

PROPERTY TRANSFERS AT DEATH

When you die, your property is going to be transferred to your heirs through one or more of the following distribution channels: probate, direct transfers by title, or living trusts (sometimes called revocable trusts). This is true whether or not you have a will. Each of these transfer methods has both advantages and disadvantages. You need to understand them so that you can intelligently choose the best methods for you. In this chapter, we will cover both probate and direct transfers by title. Transfers through living trusts will be covered in Chapter 2 of course 34154C.

TRANSFERS VIA PROBATE

Probate is the legal process whereby, upon your death, a probate judge oversees the transfer of your property to your rightful heirs. While the probate process can be complicated and confusing, it can be broken down into nine steps.

Step 1: Locate and Interpret the Will

If you have a valid will, assets titled solely in your own name or assets that name your estate as the beneficiary, such as life insurance, will pass through the probate process. Your will specifies which persons or organizations will receive your property. As mentioned earlier, if you do not have a will, state law will determine who receives your property.

Step 2: Identifying Your Estate Representative

If you do not have a will, the court appoints someone to represent your estate. This person is called an administrator. This administrator is responsible for working with the probate judge and

completing the necessary steps to settle your estate and distribute your property to your heirs. In many cases, the court will require your administrator to post a bond to provide some protection for your heirs should he or she be dishonest or incompetent. This bond is paid for out of your assets. Most states allow for the person who makes the will (testator) to waive the bond requirement in the will document. But remember, if you do not have a will, then the requirement of posting a bond cannot be waived, which will diminish the amount of property your heirs receive.

Your administrator is also entitled to compensation for his or her services. Some states have statutory limits on the amount of compensation an administrator can receive, but most states allow “reasonable” compensation. A typical fee could be 1.5 percent to 2.5 percent of the assets received and 1.5 percent to 2.5 percent of the assets disbursed. In all cases, the probate judge must approve the compensation. This is also paid from your assets. In cases where there is a will, often the will directs that the estate representative will serve without compensation, especially where that person is a family member or friend.

Step 3: Determine Who Your Heirs Are

If you do not have a will, state law will determine your rightful heirs. State laws can vary widely. To find out what your state intestacy laws are, ask one of your local bank trust officers or an attorney.

Step 4: Locate and Value All Your Property

This is often the most difficult part of the process. Suppose your estate is potentially large enough to be subject to estate taxes. In that case, all assets (meaning every item of personal property, real estate, business interest, securities, etc.) must be located, inventoried, and valued. It often requires that appraisals be ordered, which takes time and can be very expensive. Appraisals represent an educated guess of value and therefore are subject to the scrutiny and challenge of the court, heirs, and the Internal Revenue Service. Under the OBBBA, most estates will be valued substantially under the \$15,000,000 exemption amount. In such cases, the personal representative will need to list all assets and assign a reasonable value to each.

Tip

The value of certain property, such as real estate, is not an exact number but rather a range. In many cases, you'll want that valuation to be as high as possible because that estate valuation can be used as the “cost basis” for a future sale. The higher the basis, the lower the potential taxes due on a future sale.

Step 5: Identify Creditors

Your personal representative must publish legal notices of your death so that potential creditors have an opportunity to file a claim against your estate.

Step 6: Resolve Disputes

Whenever money is involved, there's a chance that disputes will arise. These problems can come from disgruntled heirs, creditors, personal representatives, disinherited parties, the Internal Revenue Service, and so on. It's the job of the personal representative (and the probate judge) to ensure that any problems that develop are resolved.

Step 7: Pay All Expenses, Debts, and Taxes

Everyone must be paid before final disbursements are made to heirs. The estate may or may not be large enough to owe estate taxes. If estate taxes are due, cash must be raised to pay them. Often, estates are long on assets but short on cash. The law has special provisions for estates made up largely of closely held business interests or farmland that allow the estate taxes to be stretched out, reduced, or eliminated. See Chapter 3 of course 34156C for more details.

Step 8: File All Tax Returns

Your estate representative must file the estate's income tax return, as well as your final income tax return.

Step 9: Distribute Property to Heirs

If you have no will and minor children or incompetent heirs are involved, the courts must appoint conservators and may remain involved for years. With a valid will, the personal representative distributes your assets as outlined in your will.

Like most things, the probate process has its advantages and disadvantages.

Advantages of the Probate Process

- Probate requires court supervision. It is, after all, a legal process. Your personal representative has a legal and fiduciary responsibility to act on behalf of your legal heirs. The probate judge supervises the process from start to finish. No disbursements are made without ultimate court approval.
- Probate is of limited duration. At the beginning of the probate process, legal notices are published in order to alert your creditors that you have died. This notice effectively sets a time limit, usually six months, after which no creditor can make a claim against your estate.
- Probate allows for postmortem planning. Since your estate is a separate taxpaying entity, your representative has the opportunity to do some postmortem planning. Through disclaimers and other strategies, taxes can be postponed, reduced, or in some cases eliminated.

Disadvantages of the Probate Process

- The primary criticism of the probate system is that it is expensive. Depending on the state in which you live, this may or may not be true. Probate costs vary widely from state to state and even from probate judge to probate judge. Many of our states' probate laws officially say that probate costs will be "fair and reasonable." What is fair and reasonable often depends on whether you are the receiver or payer of fees. If you own property in more than one state, you may have to go through probate in those states as well.
- The probate process is slow, often taking six months to several years. While your heirs can receive interim distributions, they are forced to wait for the ultimate distribution of your estate.
- The probate process is public. Anyone can go down to the courthouse and review a copy of your will, what you owned, whom you owed, and to whom you left your money. For instance, shortly after James Gandolfini, the actor who played Tony Soprano on the television series *The Sopranos*, passed away, his will was published online and debated in newspapers and business journals. Even if your will is less interesting, you may not want it read by anyone other than your heirs and attorney. We know this sounds crazy, but give it a try . . . Google "wills of famous people." It can make for some entertaining reading.

DIRECT TRANSFERS BY TITLE

One way to avoid the probate process is to set up direct transfers through the titling of your property. Property titles can be very tricky, so you must plan carefully to ensure that you achieve the desired results. How you title your property can have a profound impact on estate taxes and, ultimately, on your whole estate plan. Typically, married couples title all property jointly. While there is no best way to title property for everyone, individual case facts and goals will determine the best way to title property for you. Let's look at the various ways to title property as well as the advantages and disadvantages of each.

The most common ways of holding title are fee simple (also known as sole ownership), joint tenants with right of survivorship, and tenants in common. Some states have special laws that govern community property ownership.

Fee Simple Ownership

Under fee simple ownership, you have the title totally in your name: "John Smith." Note that this method of ownership does not avoid probate.

Advantages of Fee Simple Ownership

- Fee simple ownership is easy to establish.
- Fee simple ownership does not require the signatures of other parties.

- Property titled solely in your name allows you the freedom of total control during your lifetime. You can do with this property as you see fit without interference from other people.
- You have total control over whom the property passes to upon your death.
- Fee simple ownership may eliminate the income or capital gains tax treatment of appreciated property. If the property has appreciated significantly, then upon your death it may receive a stepped-up cost basis and the inheriting party will receive the asset at the fair market value as of the date of your death. It should be noted that a few states restrict the transfer of “fee simple” real estate without spousal consent, especially with respect to a couple’s personal residence.

Disadvantages of Fee Simple Ownership

- Upon your death, this property will be subject to the expenses and delays of the probate process. If you don’t specifically decide who will receive the property, and if you don’t execute an instrument (i.e., a will) that will cause the property to go to a specific person or organization, then those decisions would be determined for you by the current state laws.
- If you become incompetent through some form of disability, then the property will likely be referred to a court process to create a control mechanism. In Chapter 2 you will learn how to avoid this potential problem by signing a power of attorney.
- Since the property is held solely in your name, it will be included in your estate and will be subject to potential estate taxes.

Joint Tenants with Right of Survivorship

Property held as joint tenants with right of survivorship (JTWRS) could be titled as follows: “John and Sue Smith, joint owners with right of survivorship.” Under this type of ownership, you should not transfer the property or make any dispositions of the property without the written permission of the other joint tenant. If you do, you destroy the joint tenancy survivorship feature and disastrous ownership results can occur. You are, in effect, joined together in all decisions regarding the disposition of this property. Upon death, your interest in the property automatically transfers to the surviving tenant(s).

Advantages of Joint Tenants with Right of Survivorship

While titling by joint tenants with right of survivorship sounds archaic, it is actually the most common form of ownership for married couples and does have some advantages:

- Such property is not subject to probate until the death of the final joint tenant. For example, if you know that at your death you want your wife to have control and ownership

of your residence, this method will ensure that it passes to her immediately without going through the probate process.

- This type of ownership is easy to set up. It requires no special paperwork.
- JTWRS is an inexpensive way to hold title.

Disadvantages of Joint Tenants with Right of Survivorship

- This type of ownership involves, to some extent, a loss of control over the property during your lifetime. Remember, you and your joint tenant must agree on all decisions regarding the property.
- JTWRS involves a loss of control over whom the property ultimately goes to after your death. The final joint tenant will have the opportunity to decide to whom they wish to leave the property.
- Without extensive post-death planning, this method precludes having the property pass to a credit shelter trust, family trust, or QTIP trust. (These concepts will be discussed in detail later in this book.)
- For ultra-high-net-worth couples, JTWRS can lead to higher estate taxes if the joint owner is your spouse, although portability has helped alleviate this problem to an extent.
- JTWRS can lead to higher income taxes. Under current law, assets inherited receive a new income tax basis equal to fair value at death. Jointly owned assets receive a new basis of only one-half, although the rules are more generous for community property.
- Eventually, property will be subject to probate upon the death of the final joint tenant.
- With this method, it is possible that your property may pass to unintended heirs. For example, if your spouse remarries after you die, he or she could change the title to include JTWRS with the new spouse. If he or she predeceases that new spouse, the property will automatically pass to the new spouse, not to your children.
- For ultra-high-net-worth individuals, JTWRS can cause unintended estate tax problems. For example, two brothers go in together to buy a lake house. For the sake of simplicity, they decide to title it JTWRS. Upon the death of the first brother, the property automatically passes to the surviving brother. The first brother's share of the property, however, is included in his estate and is subject to the estate tax without having the property available for sale to raise cash to pay those taxes.
- JTWRS leaves property open to the claims of creditors. Take the preceding example of the brothers who bought the lake house. Let's assume that one of them is sued and receives a judgment. Under the titling of joint tenancy, that property is subject to the claims of creditors. There could be a forced sale of the property, a situation that the brother (who is not a party to the lawsuit) does not have any control over. This same problem could arise if one of the brothers were to get a divorce.