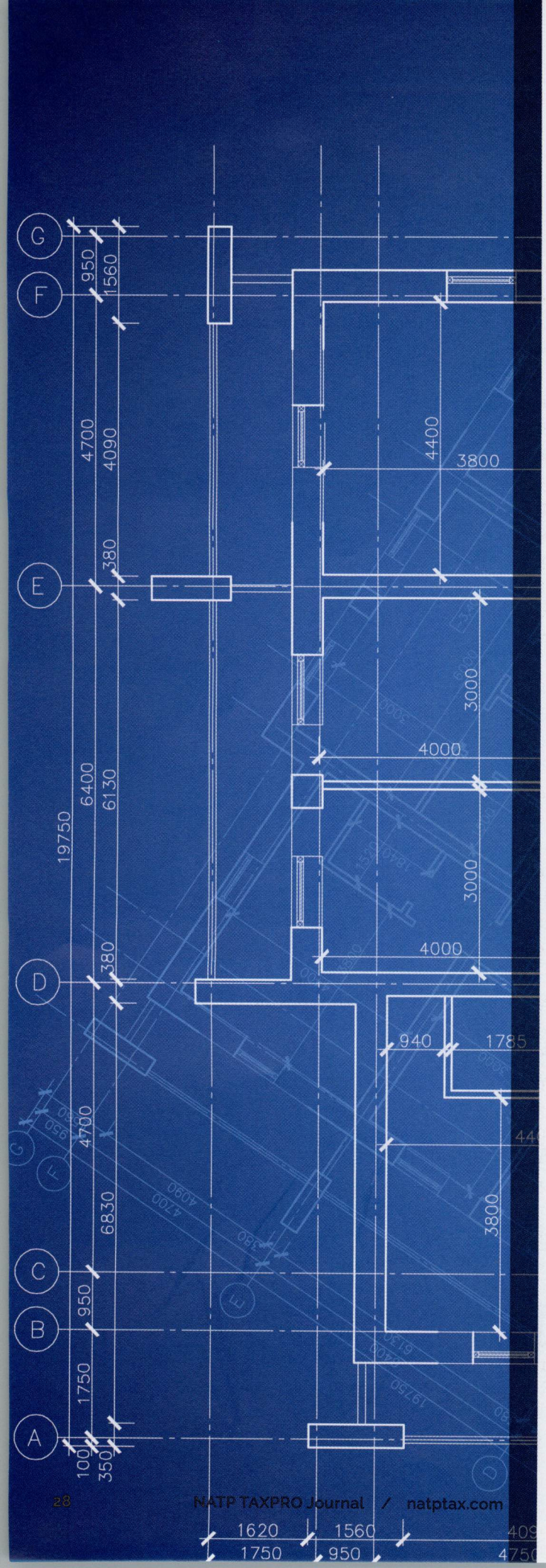
Estate Planning[1]

A look at common mistakes

By Doug H. Moy

In the broadest terms, anyone who owns property or has an interest in property has an estate.[2] Estate planning involves design and implementation of a written plan for lifetime and testamentary management of a person's estate. A carefully followed blueprint can eliminate common mistakes made in estate planning.[3]



Contrary to popular belief, a last will and trust by themselves are not an estate plan. A written estate plan is to a qualified attorney, who designs and prepares the legal documents required to implement a person's estate plan, what an architect's blueprints are to the contractor constructing a building. The legal documents carry out a person's estate plan as laid out in the blueprint. Unless issues of property ownership and beneficiary designations of contract benefits are properly coordinated, the last will and trust(s) may not carry out a person's estate plan as intended. Accordingly, an estate plan is an indispensable formal written report that describes the operation of a person's present estate plan and offers recommendations for implementing a person's estate planning goals and objectives and eliminating common mistakes.[4]

Misconceptions About Estate Planning

Unfortunately most people do not understand the process of estate planning. This is due in large part to the inability of the practitioner to communicate to the estate owner exactly what is involved in the estate planning process. Further, because estate planning involves more than just effecting a last will, trust, and other legal instruments to carry out the estate plan, many people have misconceptions about estate planning. These misconceptions, when not correctly addressed by practitioners, fuel the inertia to justify that estate planning isn't necessary against the backdrop of increasing transfer tax exemption amounts. Also, some of the following misconceptions are the primary reasons why so many so-called estate plans fail to operate as the estate owners intended.

- **Last will and trust are an estate plan.** A last will and trust(s) *are not* an estate plan. These legal documents only carry out the decedent's estate plan. Unless the practitioner conducts a thorough fact-finding interview and designs a formal, written estate plan (the "blueprint") based on the estate owner's goals and objectives, the resulting blueprint will look much like a Rube Goldberg cartoon—the end result achieved solely by chance.
- **Probate and taxes are related.** Too many people believe that probate of the estate is unnecessary if transfer taxes are not involved. Probate may be necessary if the testator/testatrix dies intestate (i.e., without a last will). On the other hand, an estate may be subject to probate when income or transfer taxes are not imposed, all depending on

the titling of property and designation of contract beneficiaries.

- **Having a last will eliminates probate.** Having a last will *does not* eliminate probate or guarantee that probate can be avoided. In truth, a person's estate may be probated whether a person dies with or without a last will. If the decedent's estate includes probate estate property (i.e., property subject to disposition under a last will or intestate disposition), probate may be required. Generally, under state law, the value of such property determines whether a formal probate proceeding is required or if the property can be administered under a state's small estate statute.
- **Probate is determined by the federal estate tax exemption amount.** Whether probate of an estate is required is not determined by the amount of the federal estate tax exemption amount. Alternately expressed, probate may still be required, even if the value of the decedent's gross estate is less than the federal estate tax or state estate tax exemption amount.

Misconceptions Contribute to Common Mistakes Made in Estate Planning

Misconceptions about estate planning contribute to common mistakes made in estate planning. Since 1979, having met with hundreds of prospective clients, this author has yet to review in the initial get-acquainted interview a person's existing last will and/or trust(s) that would carry out the person's assumed estate plan as intended. Many reasons exist for this truism; yet, the majority of the reasons can be attributed to the following common, often-repeated, mistakes:

- **Incorrect form of property ownership.** Incorrect form of property ownership is the number one contributor to estate plan failure. The paralyzing inflexibility of owning property jointly with right of survivorship, including tenants by the entirety with right of survivorship (collectively, JTWROS), causes estate plans of married persons and single individuals to fail. Last wills cannot distribute property titled as JTWROS. Likewise, a testamentary trust in a last will, or as a separate legal document, cannot be funded with property titled as JTWROS. Only if the survivorship element is severed can a last will and/or trust(s) dispose of property titled as JTWROS.
- **Incorrect beneficiary designations of contract benefits.** The present named person as beneficiary of a contract benefit may not be the beneficiary identified in the estate plan (e.g., it may be that a trust is believed to be the beneficiary of a contract benefit, but it is discovered that an individual is the named beneficiary of the benefit in the contract).
- **Design of last will and trust(s).** Too many mistakes are made in the design of last wills, testamentary and living trusts. Coupled with these errors are mistakes made in not coordinating the form of property ownership and beneficiary designations of contract benefits with the provisions of the last will and trust(s).
- **Funding revocable living trust.** It is not uncommon for a person with more than one state residence not to convey all of his or her property to a revocable living trust. Most often, such a mistake is made because the person's focus is only on the property in the state of current residence. Even people who reside in only one state make the same error with real property that they own in other states. Similarly, a trustor (grantor) may obtain a loan to renovate or remodel a principal residence. Most lenders will not loan to a trustee of a revocable living trust, even if the trustee is the person seeking the loan. To obtain the loan, the trustor removes the subject property from the revocable living trust. After the loan is granted, the trustor forgets to retitle the subject property in the name of the trustee. Also, too many times property is either not conveyed to the trust during the trustor's lifetime or the conveyance documents are incorrectly designed and prepared, thereby rendering the trust partially funded or completely unfunded.[5]
- **Life insurance ownership.** Life insurance is one of the most valuable assets available to the estate owner. Yet, its importance in providing liquidity and a source of funds for a variety of purposes is greatly misunderstood and disregarded. Mistakes are frequently made regarding ownership and beneficiary designations of life insurance policies in relation to other assets composing a person's estate. Furthermore, violating life insurance policy transfer-for-value rules[6] can subject the beneficiary of life insurance proceeds to unnecessary income tax. Life insurance death proceeds are free from income tax to the beneficiary; why should they be subject to transfer taxes?

- **Use of investment assets to provide estate liquidity.** Over-reliance on investment property to provide liquidity in an estate is also a common mistake. It makes no sense to sell semi-liquid income-producing real property, long-term growth stocks, highly appreciated securities, or property that produces tax-free income just to pay transfer taxes and estate administration expenses ("transfer costs"). Use of income-tax-free life insurance proceeds to provide needed liquidity may be more prudent. It would be the exception rather than the rule for a person to pay total premiums on a life insurance policy equal to the death proceeds. This is why life insurance proceeds are called "dollars for pennies apiece" or "discounted dollars."
- **Absence of closely held business planning.** Often, the matter of preserving business ownership and that of continuity of management are not given adequate attention in the estate planning process. Such oversight in a family business operated as a sole proprietorship may cause the business to die with the owner. Moreover, many family-operated businesses fail to develop plans to mitigate divisiveness or promote equity of participation among family members or nonfamily key employees. Finally, many estate owners make the mistake of not providing adequate operating funds for daily operation of the business upon their death.

Numerous mistakes are made in the planning of buy/sell agreements. In view of IRC §2703, particular attention must be paid to any buy/sell agreement entered into or substantially modified after October 8, 1990.[7] Despite attention that must be paid to §2703 when a buy-sell agreement is contemplated, the following questions and concerns should also be addressed to avoid unnecessary mistakes:

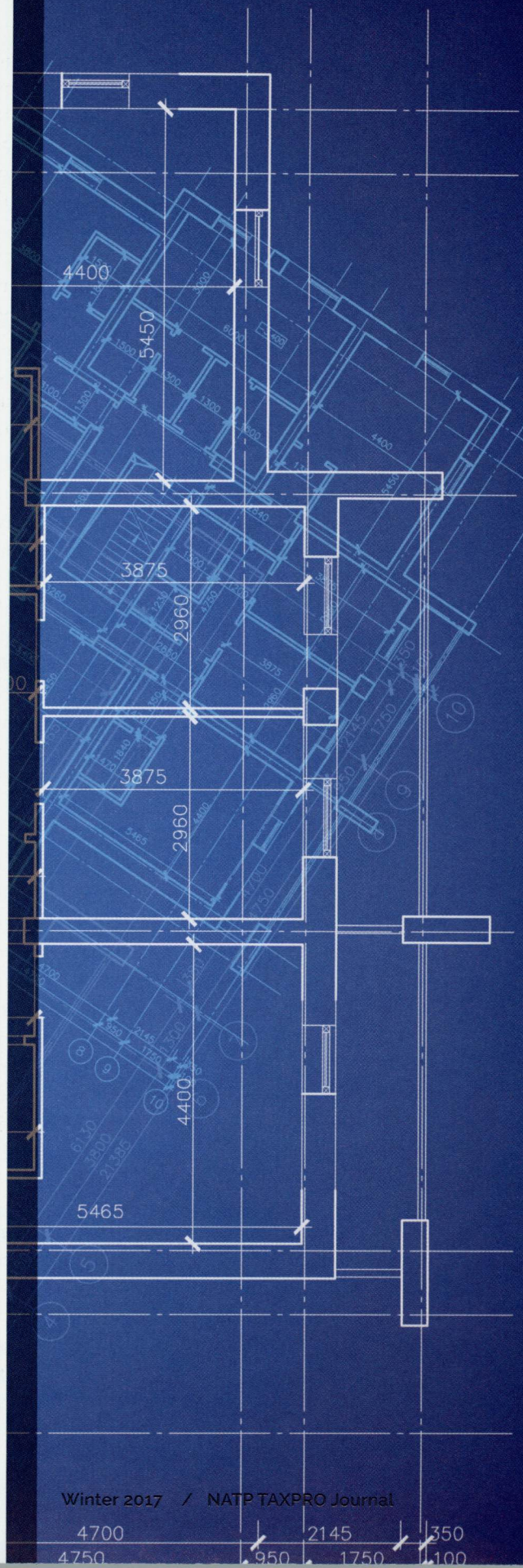
1. What method is used to determine the value of the business?
2. Are provisions made to periodically adjust the value of the business?
3. Are terms and conditions for a lifetime purchase of a shareholder's business interest the same as those terms and conditions for purchase of the shareholder's interest in the event of death?
4. Will a shareholder's interest in the business be acquired in the event of long-term disability? If yes, is the agreement funded with long-term disability insurance?
5. To avoid costly mistakes that can arise when buy/sell agreements are funded with life insurance, consideration must be given to the identity of the beneficiary of insurance proceeds [i.e., whether the decedent-shareholder's estate (or surviving spouse) or the surviving shareholder is the beneficiary].
6. Rules of attribution under §318 must be carefully observed in relation to the rules covering distributions in redemption of stock under §302. These sections of the code are traps for the unsuspecting estate planner when lifetime redemptions of stock are contemplated.
7. If a §303 stock redemption is contemplated under a stock-redemption arrangement, will the shareholder's interest in shares to be redeemed be directly reduced by transfer taxes and transfer costs?

- **Selection of fiduciaries.** A last will or trust cannot fail to operate for want of a personal representative or trustee, but both can fail to operate as the estate owner intended because the wrong fiduciary was chosen. Provisions can be made in a last will or trust for the replacement of a fiduciary by the decedent's beneficiaries. Or, absent their agreement, a court of competent jurisdiction can remove a fiduciary for cause or on grounds cited in the last will or trust.
- **Updating.** The most frequent mistake people make is not updating their blueprints, last wills, trusts or supplemental supporting documents. People simply do not realize that an estate plan is dynamic, not static. People forget that marriages and divorces; deaths and births; changes of domicile, residencies or jobs; illnesses in families; changes in tax laws; and other myriad factors influence success or failure of estate plans.
- **Ineffective fact-finding interview(s).** The fact-finding interview is a serious, important and integral phase of the overall estate planning process. In the popular television series of yesteryear, *Dragnet*, Sergeant Joe Friday always found the guilty person by obtaining "just the facts." What Joe Friday did in *Dragnet* is similar to what you must do to design and develop a comprehensive estate plan for your client.[8] Many of our clients do not know how to ask what they don't know. Have you ever experienced that feeling? In order to get the facts, you must learn what to ask your client in the fact-finding

interview, which, in turn, helps your client to ask the right questions of you. Correct answers to the questions eliminate common mistakes.[9]

Other Common Errors Made Relative to the Design and Execution of Last Wills and Trusts

- **Improper provisions for apportionment of taxes and expenses.** Tax apportionment clauses are critical to proper allocation of taxes and expenses among beneficiaries when the decedent's estate includes property eligible for the tax-favored benefits of §303 (distributions in redemption of stock to pay death taxes) or when the §2055 charitable estate tax deduction is used for property passing to charity. Moreover, when a decedent's probate estate and nonprobate estate are distributable, unless attention is paid to tax-apportionment provisions, property in the probate estate may be used to pay taxes at the expense of the beneficiaries under the decedent's last will. If such an arrangement is the estate owner's objective, fine. But, if the estate owner wants beneficiaries under the last will (and those persons receiving property from the decedent's nonprobate estate) to share in the taxes, then appropriate tax-apportionment provisions must be designed to accomplish the estate owner's purpose.
- **Divorce can partially revoke last will provisions.** Divorce can partially revoke the provisions of a last will or trust that pertain to the decedent spouse's former spouse. The mistake made is in the identification of the spouse in the decedent's last will or trust. A person remarries, does not amend the last will or trust, and then dies. The new spouse becomes the spouse mentioned in the last will or trust, but that spouse is not identified by name, only as "my spouse." This can occur if the former spouse is not identified by name but is referred to only as my spouse. The decedent spouse's estate could be denied the estate tax marital deduction if it cannot be determined which spouse the decedent had in mind—the former spouse or the new spouse.[10] On the other hand, the new spouse may receive all of the decedent's estate at the expense of the decedent's children by the former spouse. In such case, the estate tax marital deduction would be available to the decedent spouse's estate.



- **No successor personal representative or trustee.** A last will or trust cannot fail for want of a fiduciary. However, by not providing for a successor fiduciary (personal representative, executor/executrix, or trustee), the decedent's beneficiaries (or heirs, if the decedent were to die intestate) may have to incur the unnecessary expense of petitioning a court to appoint a successor fiduciary.
- **Testamentary capacity or undue influence.** A person may lack testamentary capacity or may be under undue influence to effect a last will or trust.
- **Drafting errors.** Occasionally, drafting errors are made while preparing amendments to last wills and trusts. For example, a common error occurs when the last will or trust refers to "children" of the estate owner when the estate owner has no children. It includes provisions in the last will or trust for "children" who do not exist. Was the attorney listening during the fact-finding interview? Perhaps the last will and/or trust was boiler plate!
- **Insufficient number of witnesses.** Although rare, a last will or trust can be rendered inoperative because of an insufficient number of witnesses to the testator's/testatrix's or trustor's (grantor's) execution of the instrument.

Conclusion

Estate planning is part art and part science. Effective estate planning requires knowledge, expertise, patience, design experience and thoroughness. Attention to detail is unequivocally necessary to develop estate plans that will operate successfully to carry out each client's estate planning goals and objectives and eliminate unintentional mistakes. Not all attorneys are qualified to practice estate planning and knowing that, shouldn't. There is no shame in admitting nonqualification. As my late personal attorney, Thomas P. Joseph, Jr., with whom I had developed a close working professional relationship with mutual clients, once said: "The problem isn't that there are too many attorneys; the problem is that there aren't enough good ones!" Qualified attorneys are valuable members of the estate planning team, but amateurs are not welcome. ■

Endnotes

1. Information in this article is adapted from the author's books: *Wealth Preservation: How to Start and Develop an Estate Planning Practice*. Copyright © 1998 by Doug H. Moy. All rights reserved, xvi plus 464 pages (hereafter Moy, *Wealth Preservation)*; *Living Trusts: Third Edition*. Copyright © 2003 by Doug H. Moy. All rights reserved, xvi plus 461 pages. Published by John Wiley & Sons, Inc., Hoboken, NJ (hereafter Moy, *Living Trusts*); and *A Practitioner's Guide To Estate Planning: Guidance and Planning Strategies,* 2 vols. Copyright © 2002 by Doug H. Moy. All rights reserved. Published by Aspen Publishers, Inc., A Panel Publication, New York, NY (hereafter Moy, *A Practitioner's Guide To Estate Planning*).
2. Doug H. Moy, 1 *A Practitioner's Guide To Estate Planning*, sec. 1.02, at 1-18; Moy, *Wealth Preservation*, at 7.
3. Moy, *Wealth Preservation*, at 14; Moy, 1 *A Practitioner's Guide To Estate Planning,* sec. 1.04, at 1-28; Doug H. Moy, "Estate Planning Opportunities for Tax Professionals," 16 *TAXPRO Journal* 31 (Winter 2009) (hereafter Moy, "Estate Planning Opportunities").
4. Moy, 1 *A Practitioner's Guide to Estate Planning*, sec. 1.04, at 1-28; Moy, *Wealth Preservation*, at 14; Moy, "Estate Planning Opportunities," at 32.
5. Moy, *Living Trusts*, Chapter 10, at 229.
6. IRC §101(a)(2).
7. *Omnibus Budget Reconciliation Act of 1990*, 101st Cong., 2d Sess., Pub. L. No. 101-508, section 11602(e)(1)(A)(ii) ["to the extent such amendments relate to section 2703 of such Code (as so added), shall apply to– (I) agreements, options, rights, or restrictions entered into or granted after October 8, 1990, and (II) agreements, options, rights, or restrictions that are substantially modified after October 8, 1990"].
8. Moy, *Wealth Preservation*, at 162.
9. Moy, *Wealth Preservation*, at 162.
10. IRC §2056(c) flush language.

About the Author

Doug H. Moy is a nationally recognized estate and gift tax planning specialist. Since 1979, his clients have included attorneys and tax practitioners, assisting them in representation before IRS Conference of Right, Appeals Division and Settlement Conference Negotiations. His unique communication skills enhance his unparalleled knowledge and expertise in all levels of estate taxation and plan design; living trusts; community property; lottery prize winnings; structured settlement trusts; extricating clients from abusive trust tax shelters; and preparation of estate and gift tax returns. He is a member of NATP and resides in Lake Oswego, OR. dougmoy@msn.com.