

Estate Planning Insights

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A "STRUCTURAL ERROR" THAT CAN CAUSE AN ESTATE PLAN TO COLLAPSE

There are many goals of estate planning: (i) to insure a smooth transition of assets upon death, (ii) to provide significant benefits to loved ones, (iii) to avoid, reduce and defer estate taxes and other taxes, (iv) to insulate assets from the claims of creditors (including the spouse of a beneficiary in a divorce), (v) to protect financially inexperienced beneficiaries, (vi) to create a structure allowing for professional asset management, (vii) to leave a lasting legacy, etc. Estate planning deals with the transfer of assets upon death. Unfortunately, the way some assets are titled keeps them outside the estate plan. Some individuals in the financial services industry with whom our clients also work are not as knowledgeable as they need to be when it comes to the proper titling of assets, such as bank accounts, brokerage accounts, certificates of deposit, investment accounts, stocks, bonds, mutual funds, etc. As a result, the estate plans our clients have so carefully and thoughtfully created can easily be rendered ineffective due to the improper titling of assets. We always provide written instructions to our clients regarding the proper titling of accounts and other assets but we are seldom involved at the time when a new account is opened by one of our clients. Thus, our hope is that the person assisting our clients with that very important matter will be knowledgeable regarding the legal effect of the selected form of title. Because this is often not the case, however, we are writing this newsletter on this important subject to remind our clients that they might need to educate the person who is helping them open a new account or title a newly purchased asset.

The Four Methods of Transferring Assets at Death.

Basically, there are four different methods for transferring assets at death and not all of them are "good". If a person is going to spend the time, money and effort to create an estate plan, it is vitally important that most, if not all, of the person's assets pass upon his death according to his written estate plan. This can be done by using either a Will or a Living Trust as the primary estate planning document and then "funneling" assets that pass by beneficiary designation upon death through that document. Certain other methods for transferring assets at death should be completely avoided because those assets will not be part of the client's estate plan at all (thus, defeating the plan in many cases). Here is a list of the four basic types of assets in terms of the method of transfer at death and a brief description of each:

1. Probate Assets. "Probate assets" are assets that are transferred upon death by Will or, if there is no Will, then pursuant to the state intestacy statutes. The intestacy statutes can be viewed as a Will written by the state legislature for persons who die without a Will. Writing your own Will is better than using the Will the Texas legislature has written for you. Despite statements criticizing the probate process, probate is fairly simple in Texas—probably the simplest process of all fifty states. The probate process actually has some advantages over other transfer methods. In other words, probate is not all "bad". It is also the oldest and most traditional (and,

perhaps, most reliable) transfer process. Before the advent of the other three methods, all assets were probate assets.

2. Revocable (Living) Trust Assets. To compare all four transfer methods accurately, when we discuss a transfer of assets upon death pursuant to a revocable trust (also called a "Living Trust"), we are referring only to the transfer of *those assets already titled as part of the trust prior to the trust creator's ("grantor's") death*. Assets titled in the name of a Living Trust prior to the death of the grantor are transferred at death pursuant to the trust instrument and not pursuant to the grantor's Will (and, thus, do not "go through probate"). Merely executing a trust instrument does not automatically convert assets from probate assets into Living Trust assets, however. Only assets placed in the Trust (or, "funded") before death avoid probate. To fund a Trust, so that the trust assets will be transferred at death by the trust instrument, the assets have to be re-titled into the name of the Trust before the grantor dies. This often involves additional legal documents and always involves completing relevant paperwork properly. To place real property and minerals in the Trust, a deed from the grantor to the Trustee of the Trust must be executed, filed and recorded. The title on an existing account or other asset, such as stock, has to be changed from the grantor's name into the Trustee's name to be considered part of the Trust. Converting probate assets to revocable trust assets during life is often a very cumbersome process. In Texas, many people use a

Living Trust as their primary estate planning vehicle but do not fund it at all during their lives. This makes their Trust an "unfunded" Living Trust. Sometimes the only assets placed in a Living Trust during life are out-of-state real property and minerals (to avoid the probate process in those other states, which may have a more complicated process than Texas). In the case of an unfunded Living Trust, the assets still "go through probate" at death because they are not Trust assets if not titled in the name of the Trust before the grantor's death (they are still probate assets). That is why everyone who executes a Living Trust must also execute a "pour-over Will". After a "pour-over Will" is admitted to probate, the grantor's probate assets "pour-into" his Living Trust. There are many advantages of using a Revocable Living Trust as the primary estate planning vehicle at death. See our newsletter dated April 30, 2005 for further information. However, for purposes of this newsletter, both a Will and a Revocable Trust will be considered *equally good methods of transferring assets at death* (for reasons to be further explained below).

3. Beneficiary Designation Assets. For certain assets, a beneficiary designation form is the *only* valid transfer method at death. Assets which **MUST** be transferred at death by beneficiary designation form fall into one of these four categories: (i) life insurance, (ii) retirement plans of all types (such as profit-sharing plans and 401(k) plans), (iii) IRAs, including IRA rollovers, and (iv) annuities. If you do not see something listed here (such as a bank account, certificate of deposit, mutual fund, stock, or a "regular" brokerage account), then it is *not* a "beneficiary designation asset". There are many assets that *could* be transferred by beneficiary designation at death. In other words, as an *option*, a beneficiary *could* be placed on these other assets or accounts. However, again, for purposes of understanding the information in this newsletter, if these assets are not *required* to be transferred by beneficiary designation at death, then they do not belong in this category. Only those assets for which *the only valid transfer method at death is a beneficiary designation form* will be included in this category and will hereafter be referred to as "beneficiary designation assets". (Some clients receive consolidated statements from their brokerage firm that includes different types of accounts, e.g., both IRAs and "regular" accounts; note that only the IRAs fit into this category).

4. Multi-Party Asset Arrangements. Both "accounts" and other assets (such as stock and real estate) *can* be titled or registered in a manner that results in the particular account or other asset passing upon death "outside the probate process"--either by "operation of law" or by "contractual arrangement". This transfer method can also be referred to as a "non testamentary transfer". When discussing accounts, in particular, the

term "Multi-Party Account" is used to describe these non-probate transfer arrangements. "Multi-party accounts" have one or more of the following words in the signature card or account agreement (usually in very small print):

a. "Joint Tenants with Right of Survivorship" (often abbreviated as "JTWROS" or "JT TEN"). The surviving joint tenant(s) automatically become the owner(s) of the funds in the account or of the assets subject to the arrangement on the death of the first joint tenant.

b. "Payable on Death" (abbreviated as "POD"). The listed POD beneficiary/ies automatically become the owner(s) of the funds in the account upon the death of the original depositor.

c. "Transfer on Death" (abbreviated as "TOD"). The listed TOD beneficiary/ies automatically become the owner(s) of the funds or other assets held in the account upon the death of the original account owner.

d. "Totten Trust account". This is a type of bank account in which one person is listed as the "Trustee for" one or more "beneficiaries" in a case not involving an actual trust. The beneficiaries receive the funds in the account upon the death of the "Trustee".

Again, some of the above terminology can also be placed on assets other than bank and brokerage accounts, such as stocks, bonds, mutual funds, CDs, and real estate.

The Bottom Line. Of the four transfer methods listed above, by far, *the worst method of transfer* is the Multi-Party Arrangement (the transfer method listed at item 4 above). Unfortunately, this fourth category is the transfer method that has grown in use and popularity over the past twenty-five years. Bankers, brokers, and other persons in the financial services industry often recommend (and set up) these arrangements for their customers, without understanding the havoc they are wreaking on their customers' estate plans. They will promote the use of these arrangements "to avoid probate"--as if avoiding probate is the only estate planning goal that matters (it's certainly the *only* goal you'll achieve using these arrangements). If an individual or couple has spent the time, money and energy to create an estate plan (as spelled out in their Wills or in a Joint Revocable Trust), it is thoughtless and (in my opinion) unprofessional for people in the financial services industry who are opening accounts and providing other financial products to recommend or use structures that override their customers' estate plans without providing sufficient explanation to their customers. Yet, that is exactly what happens every single day in many banks, brokerage firms, mutual fund companies, investment firms, etc. It appears to me that the financial services industry *has a long way to go* to educate their account professionals and new accounts people on these fundamental concepts. If *your* account executive has discussed these matters with you and has steered you away from the "bad" transfer

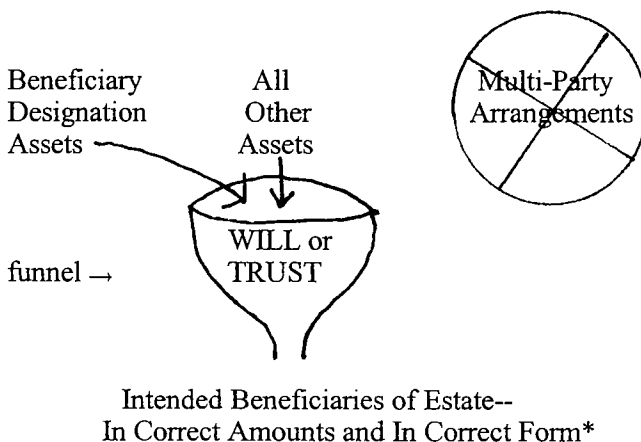
methods, then you are dealing with someone very knowledgeable. Be grateful you are in such good hands.

Good Estate Planning. The best estate plans are in writing and are necessarily somewhat lengthy. That is why a Will or a Revocable Living Trust is a better transfer method at death than a beneficiary designation form or a multi-party arrangement. If the estate plan is contained in a written legal document, the person creating the plan can have peace of mind that her wishes will be carried out in precisely the way she intended. Further, most Wills and Trusts address various contingencies in advance--because you may be mentally incapacitated when the contingency occurs (and not able to change your plan) or the contingency may occur after your death. Examples of commonly addressed contingencies include: (i) what if you and your spouse die at the same time? (ii) what if a child predeceases you? (iii) what if a person who is inheriting something from you is a minor or is mentally incapacitated at the time in question? There is just no room on a beneficiary designation form or in an account agreement to address all of the usual contingencies. Most of our clients also include various "tax savings devices" as part of their estate plan, by which I mean written provisions designed to avoid, reduce or defer estate, income and generation-skipping transfer taxes. You just cannot do any real tax planning in a beneficiary designation form or multi-party account agreement. Further, most of our clients include trust provisions in their Will or Living Trust, whether these trusts are designed to achieve tax benefits, to protect the trust beneficiary/ies from the claims of creditors (including the claims of a beneficiary's spouse in a divorce), to avoid having the probate court control the assets of a minor or mentally incapacitated beneficiary, or to control the ultimate disposition of the client's assets once his or her spouse has died (e.g., to prevent diversion of the client's assets to a new spouse or the children of a second spouse). You cannot do any trust planning in a beneficiary designation form or multi-party account agreement. Thus, the most comprehensive, efficient, and secure estate plan is one that is set out either in a Will or in a Revocable Living Trust. In other words, the *Will or Trust instrument is the primary transfer vehicle*, and beneficiary designation assets are coordinated with the estate plan through the wording that is placed on the beneficiary designation form. As noted earlier, the only assets that should have a beneficiary are those that **MUST** have a beneficiary--the assets we are calling "beneficiary designation assets" (described in item 3 above). In the case of beneficiary designation assets, by completing the beneficiary designation form in the proper way, we are moving those assets *into* the estate plan set out in the Will or Living Trust. In stark contrast, when a "beneficiary" is placed on assets that are not beneficiary designation assets *via a multi-party arrangement* (described in item 4

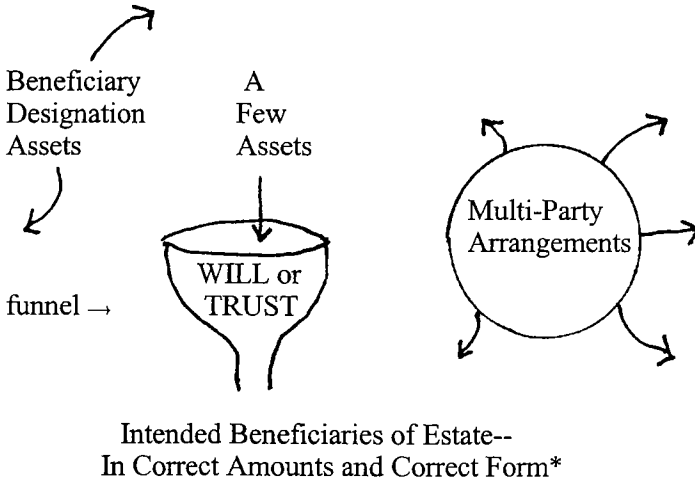
above), you are taking those assets *OUT OF* your estate plan in your Will or Trust. That is a big difference. Your accounts and other assets should not be structured to pass *outside* your Will or Trust. That is why we tell all of our estate planning clients to **avoid** as much as possible **Multi-Party Transfer Arrangements and Multi-Party Accounts** (discussed in item 4 above). We suggest you give copies of this newsletter to all your bankers and brokers and ask them to read it and study it.

Following are two pictures we have drawn to try to explain what we mean (we are not artists so we apologize for our "stick drawing" of a funnel):

GOOD ESTATE PLANNING:



BAD ESTATE PLANNING:



*achieving estate tax savings and other tax benefits, divorce and creditor protection, ultimate control (especially in a second marriage), management of assets for young and spendthrift beneficiaries, and other goals of the estate plan.

Summary. Avoid multi-party arrangements as much as possible. Be vigilant each time you open a new account or acquire a new asset to make sure these "bad" forms of titling are not used. You must do what you can to protect your estate plan from being decimated by these pervasive and harmful arrangements and forms of titling.

WELCOME TO MELISSA. We have a new secretary/legal assistant. Her name is Melissa Guinn.

ARE YOU DUE FOR A CHECK UP? If we have not reviewed your estate plan in over 5 years, you are due for a check up. Some of our clients for whom we prepared Wills more than 15 years ago have recently died and their estate plans are not optimal due to changes in the tax laws and in their financial or family circumstances over the past 15 years or so. Estate plans just don't last as long as they used to these days.

A NOTE ABOUT OUR SCHEDULING PRACTICES.

We know that it sometimes takes 6-8 weeks to get in to see us. With summer trips coming up, please call us sufficiently in advance of your vacation for an appointment if you want to make changes to your documents. Also, please allow at least 4 weeks to complete a new project once we have met to discuss it (the usual time frame from start to finish is 6-8 weeks, but when clients are "highly motivated", the project can often be completed sooner than that). We like to arrange our schedule so that we have time to do a good job for our clients and do not have to "rush through" projects. Accordingly, we try not to take in more work at one time than we can handle within a reasonable time frame. Once

we do meet with you, you will have top priority. We can usually get your documents to you within about 2 weeks of that meeting. While other attorneys may be able to meet with you right away, sometimes it takes those other attorneys 3-4 months to get draft documents out. Thus, in the long run, we believe we are as efficient as any lawyers in town. For that reason, however, we cannot always squeeze people in at the last minute (although we try if it's a "real" emergency). Thanks for your patience and understanding. Our best advice is to *plan ahead!*

And thank you also for allowing us to assist you with your tax and estate planning needs.

Contact Us:

If you have any questions about the material in this publication, or if we can be of assistance to you or someone you know regarding estate planning or probate matters, feel free to contact us by phone, fax or traditional mail at the address and phone number shown below.

You can also reach us by e-mail addressed to:

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