Estate Planning Insights

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CHANGES TO TEXAS LAW AFFECTING ESTATE PLANNING AND PROBATE

The Texas Legislature recently passed some new laws relating to Texas probate, estate planning, trust and guardianship matters. In this newsletter, we will describe and discuss some of the changes that are most connected to our area of practice.

New Rule Regarding the Probate Inventory. The Executor of an Estate (and also the successor Trustee of a Living Trust, hereafter jointly referred to as "Executor") has some very important responsibilities. One job of the Executor is to determine every single asset in which the deceased person ("decedent") owned an interest at death and to determine the fair market value of each such interest as of the decedent's date of death. This is a requirement under both federal tax law and state probate and fiduciary laws. The federal estate tax law requires that all assets be listed and valued to determine whether a federal estate tax return must be filed for the decedent's estate and whether any federal estate taxes (a/k/a death taxes) must be paid as a result of the decedent's death. The federal income tax rules provide that assets included in the decedent's estate get a new income tax basis equal to their fair market value as of the decedent's date of death, or the alternate valuation date, if applicable. Sometimes, but not always, this amounts to a "step up" in basis. A step up in basis "wipes out" all prior unrecognized capital gains on appreciated assets.

It is also the duty of the Executor to "marshall" (i.e., locate and collect) the decedent's assets and make sure they are maintained and preserved until it is time to distribute the Estate to the beneficiaries. If the decedent had any "claims" to something, the Executor must try to collect them. Of course, sometimes an Executor must sell one or more assets in order to raise cash to pay all of the "charges" against the Estate. These charges include expenses of the decedent's last illness, funeral expenses, debts, administration expenses (attorneys' fees, CPA fees, appraiser's fees), the decedent's final income taxes, state and federal estate taxes, income taxes of the estate, claims against the estate, and other charges.

Previously, within ninety (90) days of the Executor's qualification (which occurs upon filing of the Executor's Oath after being "officially" appointed as Executor by the court), an "Inventory, Appraisement and List of Claims" ("Inventory") of all *probate assets* had to be filed in the probate court records. In the Inventory, the Executor had to list the decedent's interest in all real property (including minerals) located in the state of Texas and in all other assets of any type, wherever located (excluding non-Texas real property), and set out the fair market value of each interest as of the date of death. If the asset was owned as community property with the decedent's spouse, that fact had to be indicated in the Inventory also and, in that case, the decedent's interest would be one-half. Frequently, the decedent's family did not like the fact that the Inventory had to be filed in the probate records because the probate records are "public records," meaning that anyone can view them. In our experience, however, primarily only those who needed to review the probate records, such as title companies, actually did so.

After hearing about these privacy concerns for many years, the Texas legislature decided to change this long-standing rule, *at least in certain cases and to some extent*. Here is the new rule: for estates of decedents who die after September 1, 2011, while the Executor must still prepare the Inventory, if there are no unpaid debts, except for secured debts, taxes and administration expenses, the Executor may file, instead of the Inventory, an Affidavit (i.e., a sworn document), in which the Executor states that all debts (except the excluded ones) have been paid and that all beneficiaries of the Estate have received a verified, full and detailed Inventory of all of the assets of the decedent's Estate. Thus, as noted, a copy of the Inventory must also be given to all beneficiaries of the Estate. The Estate beneficiaries *need* a copy because they otherwise will not know what their new income tax basis is in the assets they are inheriting from the decedent.

Effect of New Law: While the new law addresses the privacy concern, an additional document that wasn't previously required, the Affidavit, must now be prepared and filed and, in many cases, other additional documents, such as Executor's Distribution Deeds, will need to be prepared and filed to clear title to real property. A probated Will serves as a "Deed," but without the legal description in the Inventory, it's an insufficient Deed. Thus, there may be an increase in administration costs.

New Rule Regarding Will Execution Requirements. One of the most curious new rules is the change in the requirements for proper execution of Wills in Texas. Under Texas law, a person can execute either a Will or a "self-proved Will." A self-proved Will is always preferable to a mere Will because it eliminates the need to have witnesses testify in court to the validity of the execution of the Will (i.e., to prove that the Will was properly signed and witnessed).

Before the new rule, in order to create a "self-proved Will" in Texas, two steps were required. First, the Testator (the person making the Will) and the two witnesses signed the Will itself, and, then, the Testator and the two witnesses signed the self-proving Affidavit attached to the end of the Will. Finally, a notary public notarized the self-proving Affidavit.

Now, under the new rule, the Will's attestation clause can be written in the form of an affidavit and, in that case, the Testator and the witnesses only have to sign the document one time. The notary will then notarize this combined attestation, execution and self-proving paragraph.

Effect of New Law: Some specialists in estate planning have already adopted the new "one-step" execution, but many, including us, have not yet switched over (for one thing, software programs have not yet been updated). Probably everyone will adopt this change, sooner or later. Some practitioners have concerns about Texas clients moving to another state and not changing their Texas Will. The question is whether a state that does not recognize a "one-step" execution process will admit a "one-step" Texas Will to probate if the former Texas resident dies domiciled in that other state. Many states have adopted the Uniform Probate Code, however, which does recognize the "one-step" execution type of Will. Further, the US Constitution's "full faith and credit clause" should alleviate any concerns of this type. So, again, in the future, it is likely that everyone will adopt this new method.

Changes to Section 128A Notice Requirement. In 2007, Texas adopted Section 128A of the Texas Probate Code, which requires the Executor to give notice, within 60 days, to certain prescribed Will beneficiaries that the Will has been admitted to probate and that the Executor has been officially appointed by the court. The law also requires the Executor to give each notified beneficiary a copy of the Will and to file an Affidavit with the Court, within 90 days, swearing that the Executor has fulfilled these requirements. Since 2007, there has been a lot of confusion regarding the scope of the notice statute.

One of the technical rules, in particular, required that numerous notices be given in some cases. Section 128A provides that if any part of the Estate will be passing into a trust, the Executor need only give the Section 128A notice to the Trustee of the trust. *However*, when the same person is both the Executor and the Trustee, then, instead, the notice must be given to each "person or class of persons first eligible to receive trust income." This includes beneficiaries merely entitled to *discretionary* distributions of income from a trust. In a typical Bypass Trust created on the death of the first spouse, permissible beneficiaries of trust income include the Testator's surviving spouse, children, grandchildren, great-grandchildren and so on. In one case, we had to send out twenty-four (24) notices because of this rule!

Fortunately, this *glitch* in the prior law has been fixed. In the newly revised Section 128A, if the Executor gives the required notice to a child of the Testator, then even if that child's children (and grandchildren) are also permissible beneficiaries of trust income, the Executor need not give notices to any of the child's descendants because all of such persons are basically in the same position as the child. In other words, there is no conflict of interest in their positions so notice to the first generation beneficiary counts as notice to all of those descended from him.

In addition, those beneficiaries entitled to very small amounts (less than $2,000) and those beneficiaries who have already received everything to which they are entitled within 60 days of the probate of the Will need not receive the Section 128A notice.

Effect of New Law: These changes should save time and money in the probate and estate administration process.

Other New Law Changes. Another important change involves amendments to the sections of the Texas Probate Code dealing with "multi-party" account arrangements, and, specifically, those purporting to create a valid "Joint Tenancy with Right of Survivorship" (JTWROS) arrangement. In one of our newsletters, we previously reported on the shocking decision in the Texas Supreme Court case of *Holmes v. Beatty*. In that case, involving spouses who died within a short period of time of each other, one spouse's entire family was cut out completely due to the couple having all of their bank and brokerage accounts set up in both names as "JT TEN," "JT WROS," "Joint (WROS)" and other imitations of JTWROS. The Texas Supreme Court decision was totally inconsistent with Texas case law applicable to persons other than spouses who have these types of joint accounts. So, with the recent changes to Sections 439 and 451 of the Texas Probate Code, the mere fact that the account is labeled a joint account and purports to create a right of survivorship will *not* create a legal presumption of survivorship. In other words, the wording used to indicate the right of survivorship must be abundantly clear.

Warning About Titles: This may be a good time to remind our clients that if any of your bank, brokerage and investment accounts have been set up with "bad" labels, those accounts will *not* be part of your estate plan in your Will. In other words, the tax, trust, contingency and creditor-protection planning you have included in your Will won't apply to those assets. The bad wording, *which involves more than just the names on the account*, is often not apparent from your account statement and, in fact, the only definitive document establishing legal title is the account agreement that established the account.

You should obtain copies of all of the original account agreements for your "sizeable" accounts and look for any *bad* wording (you can ignore your checking account and other accounts with $50,000 or less in them). You are looking for wording such as this: "Joint Tenants with Right of Survivorship" (JTWROS), "Multi-Party Account with Right of Survivorship," "Pay on Death" (POD), "as Trustee for" [this "Totten trust" arrangement will only be found on bank accounts], and "Transfer on Death" (TOD). You should also review our "Frequently Asked Questions" memorandum discussing "Titling Accounts," which can be found in the "Reference Center" on the firm's website, www.gerstnerlaw.com.

These titling arrangements have only 1 advantage (they "avoid probate") and up to 6 disadvantages (all of which we have discussed before, the most significant one being under-funding a Bypass Trust created in the Will of the first spouse to die, resulting in the payment of hundreds of thousands of dollars in *unnecessary* estate taxes on the second spouse's death). So, don't let your banker tell you that these forms of title are "better" for you. We have discussed this before, and we will continue to discuss this until enough people understand that these forms of title *override your estate plan*.

Some Perspective on Legal Fees

Our final topic has nothing to do with the recent Texas legislative changes. We just want to give you some thoughts regarding legal fees and, especially, estate planning fees. Many people dislike paying legal fees. Perhaps these same people dislike paying for homeowner's insurance, life insurance, auto insurance, and health insurance, but they know they need these things, so they do it. It is the same with estate planning.

Estate planning is a thoughtful gift you give your loved ones (and, if you are charitably inclined, your chosen charitable beneficiaries). Unlike purchasing (or maintaining) insurance of various types, estate planning is not something that needs to be done every year.

We reviewed our estate planning files and discovered that 50% of our clients have estate plans that were created 10 (or more) years ago. Thus, the cost of an estate plan can be amortized over a multi-year period. However, we don't recommend that people do an estate plan once and never review it again (or review it infrequently). Both state law and federal tax law change too rapidly to make that a reasonable approach. In addition to that, changes in your family, personal and financial situation greatly impact your estate plan. Thus, we recommend an estate planning "check up" at least once every 5 years. This does not mean that we are creating all new documents every 5 years, only that we are reviewing the estate plan on a regular basis and making changes, as needed.

Let's compare estate planning to homeowner's insurance. Every year, you pay a considerable amount to insure your home against loss due to various "bad things" that can happen to it. Insurance brokers advised me that the average homeowner's insurance premium paid in 2010 for a home typical of that owned by our clients was $3,250. As noted above, our clients tend to keep their estate plans for at least 10 years. Ten years ago our average estate planning fee (covering Wills and "impaired judgment" documents) was approximately $1,800. (Today, it is approximately $2,400.) In essence, clients who spent $1,800 for an estate plan 10 years ago and whose estate plan would have worked just fine during that period spent $180 per year for "comprehensive" estate planning coverage. By this, we mean that estate planning is designed to preserve *all* of your assets, not just one asset, such as your home. Thus, the cost of estate planning compares very favorably to the cost of homeowner's insurance, which is designed to preserve only one of your assets, and the fee for which you must pay every single year, even if nothing bad ever happens to your home.

Of course, if something were to happen to your home, you would be very glad that you had homeowner's insurance. Well, there is no "if" when it comes to your death–you need to do estate planning to cover that situation. In addition, if you lose your mental capacity, your loved ones will save a lot of time, trouble and money if you have impaired judgment documents in place.

The tax savings of a good estate plan can be very great, often hundreds of thousands (and even millions) of dollars. And, yet, people do not like spending even $4,000 to avoid paying $2,500,000 in future estate taxes. I'm not sure there is anything else in our entire economy that fares as well doing a pure cost-benefit analysis.

Besides paying huge amounts of unnecessary estate taxes, failing to do good estate planning can cost your family tens (and even hundreds) of thousands of dollars in otherwise avoidable legal and administrative costs. We have seen many cases of this over the years.

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A final point about legal fees has to do with comparing our fees to fees charged by other lawyers. We know that our fees are comparable to the fees charged by other lawyers who are estate planning specialists. Our fees are going to be higher than the fees charged by non-specialists, however. In our opinion, you should not hire a non-specialist if you (or you and your spouse) have a total net worth exceeding $1,000,000 (counting the value of all assets, including life insurance proceeds). In view of the law currently on the books, this means that you have a "taxable estate" once 2013 arrives (unless Congress changes the law before then). Clients with taxable estates are being "penny wise and dollar foolish" when they seek estate planning services from an attorney who isn't a specialist in estate planning. A knowledgeable estate planning practitioner is going to understand the tax issues relating to your situation, including, but not limited to, the estate tax, gift tax, Generation-Skipping Transfer Tax, income taxation of qualified retirement plans, IRAs, stock options, etc., the income tax aspects of S corporations and other business entities, etc. In addition, she is going to consider other legal matters that affect you and your family, such as marital property laws, creditor-protection issues, non-testamentary account issues, health and disability issues, probate and trust issues. If you have a charitable intent, various options can be discussed for maximizing your gifts to charity and minimizing what goes to the government. A general lawyer is just not going to know enough to help you create a high quality estate plan. The old adage, "you get what you pay for" really applies in this area. The key is not what you pay, but whether you are receiving good value for your money. Because most lay people cannot tell the difference between high quality legal documents and mistake-ridden legal documents, the best defense to a serious problem later is to use a specialist.

We thank you for your business and for your referrals and we wish all of you a **Happy Holiday Season**.

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 above. You can also reach us by email addressed to:

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