Price & Farrington's Estate and Tax Planning *Fast*Faxts

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Estate, Tax and Wealth Planning for Advisors and Clients

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Common Estate Planning Myths and Misconceptions: *A Vigorous Debunking*

Myths die hard. Worse yet, they can stubbornly live on and on. Myths and misconceptions (we'll call them "M&Ms") abound in the world of estate planning, creating confusion, complications and wrecked plans. The best advisors help their clients steer clear of the many myths and misconceptions that jeapordize the best of intentions, and savvy clients seek out those advisors who will carefully guide them through the many minefields of planning myths. Make no mistake: many a client's estate planning foundation has been weakened by a teeming termite bed of myth and misconception.

Here's just a partial list of common M&Ms, big ones and little ones that can be equally costly in outcome. *Warning:* Don't assume that these common myths are too simple or obvious to snare you and imperil your estate plan. Most folks – no matter how sophisticated or conscientious – have fallen prey to more than one of these M&Ms without realizing it in time. My advice? *There is no substitute for good counseling from a qualified estate planning attorney to avoid these debilitating estate planning myths and misconceptions.*

M&M #1: "Estate planning is just for the rich." Variation on the theme: "I don't have a million dollars in assets so I don't need a will." Big mistake. Here's my definition of estate planning: *"I want to control my assets while I'm alive, take care of myself and my family if I become disabled, and on my death I want to leave what I have to whom I want, the way I want and when I want, as privately as possible, with the least costs, fees and taxes possible".* What's *that* got to do with just being rich?

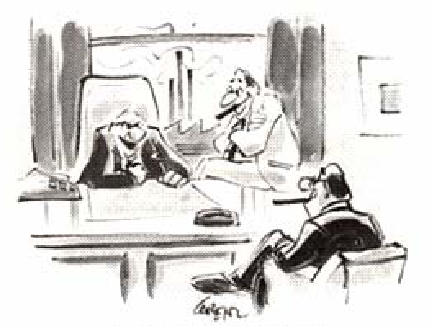
M&M #2: ***"I'm just leaving everything to my kids, so I don't need a will."*** Ah, but you might be painfully surprised how your estate actually passes if you die *intestate.* (OK, *you* might not feel the pain, but your survivors will sure suffer the consequences.)

M&M #3: ***"My kids won't fight over my stuff."*** Famous last words. This is a common misconception that results from poor communication between parents and children, and lots of denial. The cause? Inadequate planning, pure and simple.

M&M #4: "My will (or trust) determines how my estate will pass." This is a potentially fatal misconception, depending upon how you've thought out your plan, how your assets are titled and how you've designated your retirement and life insurance beneficiaries. A congruent, well designed plan is a beauty to behold, but its ugly stepsister can wipe out your best intentions if your will or trust is inconsistent with how you own your assets.

M&M #5: ***"A will is a will; I'll create one myself using a form."*** You can also build an airplane from a kit, but would you want to fly in it? I've addressed this do-it-yourself myth before. (See our *February 2003 Fast*Faxts and others in the complete archives on our web site.) An all-too-typical example: parent wants to leave her estate equally to her children. She drafts her masterpiece "on-the-cheap", which reads: "I leave my estate equally to my descendants." The estate will be split equally – among her three children *and eight grandchildren*! A serious drafting blunder resulting in an outcome neither she nor her children intended.

M&M #6: ***"Adding my children's names to my accounts will protect them."*** Protect *what*? The children? The parent? The accounts? The answer is: *none of the above*. Variation on the myth: "If I own my assets jointly with my kids, I don't need to worry about taxes, probate, nursing home claims, lawyers, accountants etc." Wrong! Titling assets in joint tenancy is all too easy, occasionally appropriate, but usually a disastrous "planning" technique. It can create serious control issues, tax complications and asset protection problems that clients cannot foresee in the absence of competent professional advice. This seriously undermines the client's planning goals and best intentions. (See our *January, 2002 Fast*Faxts, "Beware Titling Assets in Joint Tenancy", and others on our web site.)



"Well, we've licked taxes... that just leaves death!"

M&M #7: ***"If I put my kids on the accounts they'll transfer the money the way I want anyway."*** This is wishful thinking more than estate planning. When your children inherit your estate, it's theirs; they may do with it as they choose, including refuse to make any part of it available to someone or some cause you had intended to be your beneficiary.

M&M #8: ***"Estate planning is really just death planning."*** Variation: "I've got a will, so I'm set, right?" Wrong. Yes, estate planning involves planning for your death, but also a lot more. Since each one of us is 5 times more likely to be *disabled* or *incapacitated* from illness or injury in any given year than we are to actually *die* in that year, lifetime disability planning through the use of properly drawn powers of attorney and other legal instruments takes on a critical and practical importance. Effective lifetime disability planning allows you to avoid the costs, delays, publicity and frustration of a "living probate" (a guardianship) through your appointment of an agent who is legally authorized to manage your affairs and make decisions on your behalf if you're out of commission.

Even if you've already executed a will, it's simply waiting for you to die before it springs into action (becomes legally effective). It doesn't address any lifetime management issues during your disability or incapacity. A properly drawn revocable living trust, on the other hand, effectively addresses both lifetime and death time planning, privately and efficiently. It is a popular alternative to will-based planning .

M&M #9: ***"I have a will, so my estate won't go through probate."*** Wrong. A will is a written invitation to probate. Dying with a will and dying intestate both guarantee a probate administration of your estate. The end of the world? No, but something you need to know about and possibly plan around.

M&M #10: ***"I have tax-planning, so my estate won't go through probate."*** Probate is not a tax; it is a statutory, court-supervised administration of your estate at death which governs notice to creditors and title transfers. Comparing probate to tax-planning is mixing apples and giraffes.

M&M #11: ***"My revocable living trust will save me taxes."*** Yes it will if it's drafted properly, but so can a will. It's the A/B "credit shelter trust" estate tax planning provisions for a married couple, not the trust itself, that reduce or eliminate estate taxes.

M&M #12: ***"My revocable living trust will avoid probate."*** Not automatically. If your trust is an empty shell that doesn't hold your assets subject to probate, your death will trigger a public, court-supervised probate administration of your estate. The process of *funding* your trust (i.e., re- titling your assets to your trustee) is what allows your trustee to manage your assets during your disability and at your death, thereby avoiding probate.

M&M #13: ***"My revocable living trust will protect me from nursing home costs, creditors and lawsuits."*** This is a dangerous misconception. A revocable living trust is a very effective planning tool but it's not an asset protection device and won't protect your assets from Medicaid spend down.

M&M #14: ***"Estate taxes: weren't they repealed?"*** Nope. In the Taxpayer Relief Act of 2001, a confusing piece of political legerdemain, the repeal of federal estate taxes is scheduled to occur for one year only – 2010. In 2011, the Act reinstates an *applicable exclusion amount* (what a person can protect from federal estate taxes) of $1 million. Currently, the first $1.5 million dollars of a decedent's estate is protected from estate taxes and the excess is subject to tax.

M&M #15: ***At least I don't have to worry about Washington state estate taxes...do I?"*** Ouch! This one hurts. Washington's estate taxes have recently been "decoupled" from federal estate taxes, which means state taxes can be owed even where federal taxes aren't. In 2004, the first $850,000 of a decedent's estate passes free of Washington state estate tax. That amount increases to $950.000 in 2005 and to $1 million in 2006. While federal estate taxes range from 37-43% of the decedent's net taxable estate, Washington state estate taxes top out at 16%. *Bottom line*: Washington estate taxes are triggered sooner than federal taxes but are payable at a lower rate. Clients should consult their estate planning attorney and tax accountant to develop appropriate estate tax reduction strategies.

M&M #16: ***"I've kept things simple by naming 'my estate' on my life insurance policies and retirement plans."*** Alas, a simple goal can lead to complicated results. While naming *"my estate"* as your designated beneficiary can be appropriate under some circumstances, it is often a poor choice. For starters, it automatically transforms non probate assets into fully probatable ones. This unnecessarily subjects those assets to the publicity, delays, fees and statutory requirements of the probate process. Naming the estate as beneficiary of a qualified retirement plan can also adversely impact the plan participant's long-term tax-deferral and asset protection strategies.

With an increasing proportion of our clients' wealth held in assets bearing beneficiary designations, the way the designation is "drafted" is critically important. If the estate plan involves multiple beneficiaries, special needs cases, trusts, tax-planning or asset protection – to name a few – your beneficiary designations must be carefully and artfully crafted to underscore – not undermine – your overall estate plan. Naming your "estate" can be simple *and* simply self-defeating.

M&M #17: ***"The death benefit on my life insurance policy isn't part of my taxable estate."*** This is a common myth that leads to poor planning and costly results. Any "incidents of ownership" in a life insurance policy will cause the full value of the death benefit to be included in your net estate for purposes of calculating your estate tax liability. *Example:* A $1 million life insurance policy is owned by the decedent to create cash on his death to pay estate taxes. Close to one-half of the death benefit will end up being consumed by the very taxes it was intended to pay!

An irrevocable life insurance trust (ILIT) is a common planning technique used by our clients to avoid this problem, allowing every dollar of the death benefit to remain outside of the taxable estate and available to the beneficiaries. In our $1 million dollar example, the cost to the client to establish the ILIT represents about 1/250 of the taxes he'd otherwise owe.

If parents decide to have their children own the life insurance policy on the parents' lives isn't this a good way to remove the death proceeds from the parents' estates? Yes, but it overlooks vital planning advantages of a trust. The child could run into financial difficulties and fail to make the premium payments or develop creditor problems and lose the cash value of the policy to a judgment creditor. These undesirable outcomes can seriously undermine your estate plan and can easily be avoided with a properly drafted and administered ILIT.

M&M #18: ***"I did my will a long time ago; nothing has changed since."*** People change. Goals change. Laws change. Family and financial circumstances change. Children and other beneficiaries change. Births and deaths occur. Life happens. Over time, changes which have occurred in your life, outlook, goals and circumstances gradually forge a new reality. An estate plan put in place many years ago (if it was, indeed, a *plan* at all) can become dangerously outdated, enshrining obsolete goals and failing to address – or actually undermining – important new ones. An out-of-date estate plan can be worse than no plan at all. If your car deserves regular maintenance and upkeep, doesn't your estate plan deserve anything from a tune up to an overhaul, as needed?

Example: Two of your most basic estate planning tools, the *financial and health care durable powers of attorney*, should be updated and re-executed about every five years. Even if not much has changed in your life, your ability to have these critical documents honored by banks, title companies, brokerage houses and health-care providers at the very time they need to be honored is greatly enhanced if they are perceived to be reasonably current. ■

We've barely scratched the surface of estate planning myths and misconceptions. Please feel free to contact us so we can help you and your clients confront and overcome the worst of them.

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