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

March, 2004

Estate, Tax and Wealth Planning for Advisors and Clients

Price & Farrington, PLLC
Attorneys and Counselors at Law
12501 Bel-Red Road, Suite 215
Bellevue, Washington 98005
425-451-3583
Email: contact@pricefarrington.com

Your Basic Will: *Even a simple last will is not so simple anymore.*

"What sort of will would you like, Mr. Fignewton? Short and simple?...Or one that will go clear to the Supreme Court?"

Drafting a will, even a basic one, is anything but basic in a world of unpredictable events. Estate planning lawyers have to anticipate changes that inevitably arise. Some are forseeable: clients will fail to update their plans to reflect new marital status, asset ownership, beneficiary changes and other significant developments.

Let's take a look at some recent issues affecting the basics, such as holographic wills and surrogate parenting, to alert ourselves to potential traps.

The Holographic Will

For better or worse, people sometimes draft their own wills, a document that is referred to as a holographic will. State laws define the requirements of a holographic will, typically a will completely in the testator's (the maker's) own handwriting, but not attested by witnesses. These laws specify where the testator signs, whether witnesses are necessary and whether the will must be entirely handwritten.

There's a big risk that a holographic will will fail to meet state law requirements, be declared invalid, and lose valuable tax savings. Unwitnessed holographic wills always raise interesting issues about the testator's intent. (The only holgraphic wills valid in Washington are those executed outside Washington in a state that permits them, or while the testator was domiciled in such a state.) Planners should advise clients to exercise great care in this area.

Revoking Wills

After identifying the testator, a will usually revokes all wills and codicils (will amendments) previously made. If a newly executed will or codicil fails to expressly revoke all prior wills and codicils, its provisions will control *only if they are inconsistent* with the prior document(s).

With the divorce rate above 50 percent, many states, including Washington, have enacted laws which automatically revoke will provisions that favor a spouse if the testator divorces after making the will. Whether an annulment or separation revokes such provisions depends on the particular state's laws.

Be cautious. These laws do not automatically revoke beneficiary designations in ERISA retirement plans. The U.S. Supreme Court ruled in *Egelhoff vs. Egelhoff* that the Employment Retirement Income Security Act (ERISA) of 1974 *pre-empts* a Washington state law that said divorce revokes the beneficiary designation of a spouse on non-probate assets. The court allowed the *former spouse* to remain the beneficiary. And such statutes usually don't address whether a beneficiary who is the spouse of the testator's *child* remains a beneficiary after divorce.

Advisors need to remind clients who divorce that they should revise their estate plans and their all-important beneficiary designations. Well-drafted documents should state whether distributions to a family member's spouse depend upon an existing marriage.

Updating and Property Memos

There is also the thorny issue of whether later, "updated" documents revoke earlier ones. Planners should ask clients about existing memorandums and address them when revoking or amending a will.

Many states, inlcuding Washington, allow clients to leave tangible personal property (e.g. jewelry) by a separate memorandum that is executed before or after a will, and that the will refers to. This practice creates some difficult issues such as whether or not the memorandum is automatically revoked by a later executed will.

The Idaho Supreme Court addressed this issue in 2002. The testator in this case died in 1997; he was survived by five adult children and his partner, Charlotte, with whom he had cohabitated for 14 years. The decedent's 1995 will referred to an attached personal property memorandum distributing some property to his children, as permitted by Idaho law. Shortly before his death in 1997, the decedent executed a final will and expressly revoked "all prior wills and testamentary powers...heretofore made by me." In the 1997 will, the testator said that he intended to make a separate written instument leaving items of tangible personal property and that if no list were made, the property should pass to his partner.

The Idaho Supreme Court admitted the 1995 memorandum to probate with the 1997 will. It ruled that the will did not revoke the memorandum because the memorandum was not a testamentary (i.e. effective at death) instrument. The justices determined that the language of the 1997 will contemplated the existence of a separate writing, but because there was no indication of a later writing, the court ruled that the 1995 memorandum controlled.

The New Family

Today's families are increasingly non-nuclear: single parents, untraditional relationships and unmarried couples. Many people have had prior marriages. Many children are adopted or born with the help of reproductive technology. In light of this, clients should carefully review and revise will clauses defining "family". Wills should clearly identify family members and other beneficiaries—and should explicitly exclude those whom the client wishes to *disinherit*. This avoids the issues of whether a disinheritance was intentional. In blended families, each spouse often makes specific gifts of family property to heirs, gifts that

can be satisfied only with that specific item of property. The will should spell out what happens if the property no longer exists at death or if the beneficiary dies *before* the testator. Unless the will says otherwise, gifts intended for family members who predecease the testator generally pass to that member's children (under the state's "anti-lapse" statutes). To override such statutes, wills should address what happens if the beneficiary dies before the testator.

Ademption

Under the doctrine of "ademption", if a specific asset earmarked as a bequest no longer exists at the testator's death, it is considered "adeemed" and fails. The question is: was this the testator's intent?

One case illustrates the confusion surrounding ademption in the context of gifting business interests. The testator gave specific company stock to his son and later entered an agreement granting the company and son the right to buy his stock at death. At death, the company exercised the option, giving cash to the estate. The court examined whether the son should get the cash or if the gift was adeemed. It held that, because the decedent owned the stock at death, the gift was not adeemed; therefore, because the stock was specifically bequeathed to the son, the son received the cash (the proceeds of the stock sale).

Beneficiaries

Courts are often asked to identify who are the takers of so-called "class gifts". As non-nuclear families and long-term trusts increase, so do such cases.

In Texas, a court held that a class of beneficiaries described in a will as "my nieces and nephews" referred to the decedent's nieces and nephews and not those of the decedent's wife. The Texas Court of Appeals reversed the decision, holding that the phrase "my nieces and nephews" didn't have a clear, legal meaning and that the trial court could consider relevant "outside" evidence.

An Illinois court addressed the inheritance rights of children born after marriage who are left out of a will. The decedent executed a will giving tangible property to his "children", naming *only children of his second marriage*, followed by a gift of the residue to "his children." The children by his first marriage argued that the will was ambiguous and they should come within the meaning of children in the residuary clause. The court found no ambiguity, stating that "child" is not a technical legal term with a fixed meaning, but is flexible and should be construed as the testator intended. The court found that by specifically naming children of his second marriage, the decedent showed his intent to disinherit all other persons.

Recently, the Supreme Judicial Court of Massachussetts interpreted a *testamentary* trust (a trust drafted in a will) established in 1914 and distributing in 1997 to determine whether the testator's intent was to include the adopted daughter of the testator's grandson within the term "representatives". The court concluded that the daughter had a right to share in the trust. This highlights the care necessary in drafting long-term trusts.

Trust Funding

Basic tax planning for a married couple typically includes having the estate of the first decendent fund a "bypass trust" to minimize overall transfer taxes. Often the trust is not funded when the first spouse dies, especially when a surviving spouse is trustee. This jeopardizes transfer tax savings and frustrates the first decedent's intent.

In a recent string of cases, the I.R.S. used the *surviving spouse's* death to evaluate trust funding on the first death. Children are likely to raise funding issues when the surviving parent remarries, particularly if that parent begins shifting property to the new spouse. Because inappropriate funding can result in taxable gifts, trust beneficiaries should carefully evaluate funding issues. To avoid problems, good probate attorneys will include trust funding as part of the estate administration, and planners should routinely ask about and review plans of any deceased spouse.

Brave New World

So much for the routine, thorny issues. New legal theories and medical technologies have come along to complicate matters further, sometimes expanding traditional definitions of family long after a will has been executed.

Some states permit children who are not formally adopted to inherit from someone who would have adopted the child under a theory known as "equitable adoption". West Virginia applied this theory in a case in which the testator died intestate (i.e. without a will) and was survived by one son. The claimant was raised by her grandmother and the testator, who was her step-grandfather. After the death of the claimant's grandmother, the testator continued to raise her. After his death, she asserted her right as an heir. Based on the claimant's relationship to the decedent, the court held that the claimant was "equitably adopted" and was indeed an heir.

Artificial insemination, frozen embryos and other technology permit men to become fathers posthumously and women to become pregnant by a person other than her husband. Posthumous reproduction raises new problems for the estate planning lawyer, including questions about inheritance rights and orderly estate administration. States' "pretermitted heir" statutes—which typically protect children from disinheritance who were conceived before but were born after the testator's death—are now being tested when children are born after the testator's death by reproductive technology.

In a New Jersey case, the court decided that twins born 18 months after the decedent's death with his frozen sperm were heirs under the state's laws, providing that "[the decendent's relatives] conceived before his death but born thereafter inherit as if they had been born [in the decendent's lifetime]". The court found that the issue of heirship was "appropriate because of the effect it has on [the heir's] general legal and social status and because of the impact which it may have on property rights over time".

Stay Alert

Drafting basic will provisions requires planners to address many issues in the midst of change. Clients who understand the importance of keeping their plans up to date and accurate need to keep their estate planning attorney informed. Anything less can undermine the estate plan, creating a real mess. ■

Glen D. Prien