

# Price & Farrington's Estate and Tax Planning Fast Faxes

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## Life and Estate Planning: *The Top Ten Mistakes*

*Lists, Lists, Lists. They can annoy us, but they also serve to remind us. These "Top Ten Life & Estate Planning Mistakes" are intentionally unnumbered because they are in no particular order. The significance of any given "mistake" will vary given your unique planning objectives, which themselves will vary with changes in your life, the lives of your loved ones and your assets. Listen up, and share this with your clients, colleagues and friends...*

### Common Estate Planning Myths

*Estate planning is a complicated area where many myths abound which can be harmful to you and your loved ones:*

**1. If I have a good will, probate won't be required.** Having a will actually mandates probate in most circumstances, possibly delaying transfer of assets to heirs for months or years.

**2. I don't need a will if I have a small estate.** If you don't have a valid will, Washington statutes will dictate where your assets go and who will administer your estate. You might not like it.

**3. If I don't have a will, all my assets will go to my spouse.** That's not necessarily where the law directs your assets. Unexpected outcomes are common, and can be nasty.

**4. If my assets don't exceed \$600,000, I will avoid probate.** In Washington, an estate over \$60,000 or with real estate will probably require probate, unless you have a living trust or a probate-avoidance plan.

**5. A will covers all my assets.** Nope. Joint tenancy, retirement plans, annuities, life insurance, and payable-on-death accounts all pre-empt your will.

**6. Only the rich need to worry about estate taxes.** In Washington state, any estate exceeding \$700,000 will trigger Washington estate taxes.

**7. I can do my own estate plan.** Really? Good luck. Hope you don't

### *No Plan, Wrong Plan, or Outdated Plan*

Probably the most common mistake is the failure to plan, having the wrong plan or even having an outdated plan. Statistically, 70 percent of Americans have no plan at all. Anecdotally, 20 percent have the wrong plan or an outdated plan. Only 10 percent have a proper and current estate plan, but unless they view Life and Estate Planning as a lifetime process even those plans may become wrong or outdated. The mistake is commonly the result of good, old-fashioned procrastination. Consider it human nature. As a matter of personal responsibility, only you can make your own Life & Estate Plan a top priority. Take time to carefully think through, implement and then update your plan. You and your loved ones will be glad you did.

### *No "Incapacity" Planning*

Too many people regard estate planning as merely an after-death distribution program for their assets. While this is an important component of proper planning, a comprehensive Life & Estate Plan begins with planning for the possibility of your own incapacity. The law requires every adult American to make his or her own personal, health care and financial decisions. If you haven't legally appointed the agent/decision maker of your own choice in advance of your incapacity, one will be selected for you by a probate judge who likely doesn't know you or your wishes. This process will invade your privacy by making your personal and financial circumstances a matter of public record.

### *No "Back-Up Parents"*

Silver and gold aside, most Americans consider their children to be their most important assets. Parents devote considerable time and treasure to providing education, social/athletic activities and religious training for their "two-legged investments". Incredibly, these same



The hazards of poor estate planning.

parents typically fail to legally appoint the guardians (i.e. "back-up parents") for their minor children in the event both parents die. Who do you name as guardians to take your place and take care of your most important "assets"? What instructions would you give the guardians to carry out your goals, hopes and expectations for your children? You must legally appoint the guardians in advance of tragedy. Listing the guardians on a cocktail napkin at the airport lounge doesn't make for effective planning.

### *No Inheritance Protection*

No one values a dollar like the person who earned it. If you don't incorporate inheritance protection into your Life & Estate Plan, your hard-earned assets could be squandered by your surviving spouse's new spouse, your children/grandchildren, or through divorces, lawsuits or bankruptcies. Most people are aware that the divorce rate today is about 50%. This has spawned a new term when someone gets married – it's called a "starter marriage". With middle class folks leaving hundreds of thousands of dollars to their children, doesn't it make sense to protect it from a 50% divorce rate? By leaving assets to your children

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in a properly designed trust, you can not only protect it from a divorce but also from creditors in the event your son or daughter ever gets sued. This means that their money is protected:

- (1) if they or someone they are responsible for ever has a major medical problem;
- (2) if they get sued for a personal injury claim; or
- (3) if they lose their job or business and have to file for bankruptcy, etc.

Most estate plans leave the money to the children. So let's say that you've left \$250,000 to your son and \$250,000 to your daughter. If they die (remember, this is after you're gone), who inherits from them? Your son-in-law or daughter-in-law. Can they get re-married and share your \$250,000 with a complete stranger? It happens all the time. What can you do about it? Leave your assets in a special trust for the benefit of your kids, which provides that when they die whatever they didn't spend goes to your grandchildren or your other surviving children, instead of to your in-laws.

#### ***No Basic Estate Planning***

In 2003, a married couple, assuming both parties are U.S. Citizens, may lawfully protect up to \$2.0 million\* of their assets from federal estate taxes through proper Life & Estate Planning. However, if your "plan" includes the joint ownership of assets between spouses, with reciprocal beneficiary designations and followed by simple, "sweetheart" wills, you are likely shortchanging your loved ones and unnecessarily enriching the IRS.

*(\*Note: Under the Economic Growth & Tax Relief Reconciliation Act of 2001, this figure is scheduled to increase incrementally until the estate tax is completely phased out in 2010. However, the repeal is only for the year 2010. The new law expires on January 1, 2011 and we revert to the law that existed prior to the repeal.)*

#### ***No Estate Tax Planning For Life Insurance.***

Life insurance is a fundamental financial tool for most Americans. Whether it's intended to provide for a surviving spouse and minor children, help provide cash liquidity to satisfy federal estate taxes, or a host of other valuable uses, most Americans don't own enough life insurance and don't own their life insurance properly. One of the greatest tax myths is that life

insurance death benefits are "tax-free". While a lump-sum payment of the death benefit may be "income tax-free" when received by the beneficiary, the entire value of the death benefit is part of the policy owner's estate for federal estate tax purposes. This is true if the policy owner held any "incidents of ownership" (e.g. access to any cash value, the authority to change beneficiaries, or even the ability to cancel the policy) at the time of their death or transferred ownership of the policy within three years of their death. You can structure your life insurance to avoid federal estate taxes and still fulfill your objectives through a properly structured and coordinated Life & Estate Plan. Otherwise, you have unintentionally made the IRS the beneficiary of over half your life insurance.

#### ***No Probate Avoidance Planning For Multi-State Real Estate***

Unless you plan otherwise, real estate is subject to probate in the state in which it is located. Accordingly, if you own real estate outside Washington, it may be required to go through probate in the state where it is located before it is transferred to your loved ones. Probate, whether in Washington or in another state, can be avoided if you desire. In some states, probate is less burdensome than in others, but if you choose to avoid probate, you must make appropriate legal plans in advance.

#### ***No Income Or Estate Tax Planning For Retirement Plans.***

Because of the unprecedented performance of the stock market over the last several decades, coupled with the government's encouragement of employer-sponsored retirement plans, much of the private, individual wealth in America is in qualified retirement plans. Without careful coordination between their financial plan and Life & Estate Plan, over 75% of a married couple's retirement money will go to the IRS instead of to their loved ones. With proper coordination, the tax impact on these unique assets can be substantially lessened. IRA rules allow you to multiply your IRA ten times or more by "stretching" them out for your children or grandchildren. When a parent dies and leaves an IRA to a child, the child may not roll the IRA over into their own, but must instead take a distribution. With proper advice, your son or daughter can elect to take the distribution out in small increments over their lifetime. For

example, if son is age 30 when parent dies, he has a 52-year remaining life expectancy. If he elects for the "stretch-out", he takes 1/52<sup>nd</sup> next year, then 1/51<sup>st</sup> the following year, and so on. If son was left \$100,000, only took the minimum distribution and earned an average of 10% per year on the investment, he would end up getting \$2,750,000 from mom and dad's IRA! Not too shabby.

#### ***No Business Succession Planning***

Statistically, only 30% of family businesses survive from the founding generation to the next. The success rate after that is even more dismal. Just like individuals, business owners fail to make plans, have the wrong plan or even an outdated plan for the eventual transfer of their business. A comprehensive Life & Estate Plan can incorporate planning for business succession. For example, if some children are "active" in the business and others aren't, how do you treat everyone equally as well as fairly? There are effective ways to do it.

#### ***No Tax-Savvy Lifetime Giving Program***

One often overlooked opportunity under the tax code is the "annual gift exclusion" which allows you to give up to \$11,000.00 tax-free to as many individuals as you desire. No tax is assessed on the gift. For estates already subject to potential federal estate taxes at rates ranging from 45% to 50%, this technique not only removes the gifted asset's value from the donor's estate, but also removes any future appreciation on the asset. Seek out competent professional advice before making a gift of "appreciated property" because of special capital gains treatment such assets receive upon the death of the asset owner. ■

*This is a partial list, and in no particular order. No one knows your planning needs as well as you do. If you need help prioritizing and designing your or your clients' planning, feel free, as always, to contact us for assistance.*



*Glen D. Pina*