Estate Planning Insights

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Some Mistakes Some People Make and Other Matters

First Problem: Not Having A Will. Most people in the U.S. die without a Will. This is called dying "intestate" (without a Will). In some cases, it may not matter too much because some people do not own any "probate assets" at the time of their death. Probate assets are assets that are transferred at death pursuant to a Will, if there is one, otherwise, pursuant to the "intestacy laws." The intestacy laws provide for the distribution of the decedent's probate assets to the decedent's legal heirs when there is no Will. Basically, those laws are a Will written by the legislature for people who die without a Will.

Typical probate assets include real property and mineral interests, business interests, and tangible personal property. Other assets, such as bank, brokerage and investment accounts, *may* be probate assets, depending on how they are titled. These days, a large number of accounts at financial institutions are structured as non-probate assets, which means that they pass outside the decedent's Will at death. While "avoiding probate" appears to be a good thing, that is not always the case. However, that is a topic for another newsletter.

Even if a decedent did not own any probate assets at the time of his death, often there are matters that must be handled after his death, such as filing his final income tax return, paying his debts and taxes, and collecting amounts due him. In a Will, the "Testator" (a person who makes a Will) can name an Executor to handle all of the post-death matters. In Texas, to insure an *independent* administration of the estate, the Testator should name an "Independent" Executor in his Will (see below). Thus, having a Will enables an Executor to be appointed who can handle the post-death matters that need to be handled after the decedent dies.

Second Problem: Writing Your Own Will. Probably one of the biggest mistakes that lay people make is writing their own Will. Below are some of the typical problems with "homemade Wills."

1. Not Defining Family Members. If a Testator leaves all of his estate to his wife, he should be sure to identify his wife in his Will. Or, if the Testator leaves his estate to his children, he should include the names of his children in his Will. Full legal names, rather than nicknames, should be used in a Will. It is possible to include "future children" in a Will by using a definition of children that includes both already living children and children born to, or legally adopted by, the Testator after the date of the Will. Step-children are not treated as legal children. Thus, if the Testator desires to include step-children as beneficiaries in his Will, he must specifically say so. If the Testator wants to "leave out" a family member who would otherwise be an heir under the law, he should at least mention that person in his Will so that the omitted person cannot argue that the Testator was so out of his mind that he didn't know who his relatives were.

2. Not Making Clear What Happens if a Beneficiary Predeceases the Testator. It is always possible that one or more beneficiaries named in a Will might predecease the Testator (or die in the same accident). Lay people tend not to address this possibility when they write their own Will. For example, if a child of the Testator predeceases the Testator, should that predeceasing child's share be distributed to the Testator's other children, in equal shares, or should that predeceasing child's share be distributed to the children of that deceased child? The latter is what is commonly referred to as a "per stirpes" distribution (there are variations of *per stirpes*, but

we are going to keep things simple at this point and not go into that). Texas has a statute that provides for alternate beneficiaries in the case of certain beneficiaries who predecease the Testator (the "anti-lapse statute"). The anti-lapse statute may not provide the result the Testator intended.

3. Not Appointing an Independent Executor, to Serve without Bond. As previously noted, when a person dies, it is usually necessary to have someone in place as the "official representative" of the decedent and his estate to handle the post-death matters. Otherwise, it can be extremely difficult for the decedent's affairs to be properly concluded. In Texas, we have two different kinds of estate administration: independent and dependent. Independent administration is faster, cheaper and simpler than dependent administration. In order to obtain an independent administration, in his Will, the Testator must appoint an "Independent Executor to serve without bond." Doing that insures that, once the Executor is officially appointed as Executor by the probate court, the Executor can then handle everything that needs to be handled without court control and supervision. Of course, it's very important to appoint a trustworthy, responsible person as Executor because the court will not be reviewing or approving the Executor's actions. Also, it's important to say that the Executor need not obtain a fidelity bond because, otherwise, the court will require the Executor post a bond. Many individuals cannot qualify as Executor if a bond must be posted because they cannot qualify for a fidelity bond.

4. Problematic Disposition of Assets. Most lay people do not know how to dispose of assets in a legally effective way, or they do it in a way that causes serious problems. The most common mistakes that are made in a homemade Will are (i) making a "specific bequest" (or, specific gift) of each asset, (ii) not having a "residuary clause," and (iii) attempting to dispose of non-probate assets.

While making some specific bequests in a Will is typical, it is not a good idea to attempt to do that with each and every asset. Normally, specific bequests are made (i) when the Testator wants a particular asset (such as the baby grand piano) to be distributed to a particular person or (ii) when the Testator wants a particular beneficiary to receive a finite amount (only). Ordinarily, the bulk of the (probate) assets that a person owns should be thought of as one big pot that is going to be divided among the "major" beneficiaries based on fractions or percentages (whether equal or unequal). That is the idea of including a "residuary clause" in a Will. By designing a Will that makes specific bequests first, and making sure that the specific bequests do not total so much that nothing is left over, and then distributing the bulk of the estate to the major beneficiaries pursuant to the "residuary clause," a number of serious problems can be avoided.

One problem with the itemized asset approach is that the assets a person owns on the day he dies are likely to be different from the assets the person owned on the day when he wrote his Will (unless he wrote his Will on his death bed). In addition, when using the itemized asset approach, people invariably omit from their Will one or more assets they own an interest in, resulting in a partial intestacy as to those assets. Having any assets pass by intestacy defeats one of the main purposes of having a Will (and drastically increases the probate and administration costs).

A residuary clause is a "catch-all" clause that should be included in every Will to avoid dying intestate as to any assets. It is basically a distribution of the Testator's interest in *all remaining probate assets passing under the Will* (meaning the probate assets not distributed as specific bequests). Again, in most cases, the residuary clause should transfer the bulk of the probate assets owned by the Testator to the major beneficiaries. As noted above, the beneficiaries of specific bequests are persons who are entitled to a specific asset or a specific dollar amount only. Sufficient assets need to be left over after all of the specific bequests are made because it is typically the "residuary estate" (the assets being distributed pursuant to the residuary clause) that the Executor uses to pay the following items: the Testator's funeral expenses, final income taxes and debts, the post-death administration expenses, including the expenses of maintaining the assets during the administration period, legal fees, accounting fees and executor's fees, federal estate taxes, if due, and income taxes payable by the Estate. If the residuary estate is insufficient to pay these items, then the specific bequests will have to be sold by the Executor to pay these items. Also, in that case, the beneficiaries of the residuary estate will receive nothing because they are only entitled to the net residuary estate after all debts, expenses and other post-death charges have been paid.

Another common problem is that lay people often attempt to dispose of non-probate assets in their Will. A Will has no control over non-probate assets. Since it is not possible to dispose of non-probate assets in a Will, the actual disposition of assets that the Testator intended to make may not occur.

There are basically three (3) categories of non-probate assets: (A) beneficiary designation assets, (B) multi-party accounts/assets, and (C) trust assets. Within the beneficiary designation category, there are basically four (4) sub-types: (i) life insurance, (ii) employee benefit plans, (iii) IRAs, and (iv) annuities. Within the multi-party account/asset category, certain forms of title or account arrangements cause the account/asset to pass outside probate (and outside the Will) at death, including: (i) joint tenants with right of survivorship (JTWROS or Jt Ten), (ii) Pay on Death (POD), (iii) Transfer on Death (TOD), and (iv) the "Totten trust" account (a bank account titled, "John Doe, Trustee for Mary Smith," where there is no actual trust). Assets owned by both revocable trusts and irrevocable trusts are almost always non-probate assets (the only exception being assets in a revocable trust that are distributable to the trust settlor's *probate estate* upon his death).

In view of the fact that a Will can only dispose of probate assets, it is not correct to provide for the disposition of non-probate assets in a Will. Thus, a Testator should not say in his Will that he is leaving his IRA to X and his life insurance to Y. Such provisions in the Will are totally ineffective.

5. Attempting to Dispose of An Asset That the Testator Does Not Fully Own. This can happen both in the case of a Testator who is single and a Testator who is married, but it happens much more often in the case of married Testators because of Texas community property law. Community property is a difficult marital property system for many people to understand, especially those who have previously lived in a common law or "title" state. In the non-community property states, the title of an asset usually tells you the owner of the asset. That is not true in Texas. In Texas, the title of an asset often only tells you the "manager" of the asset. To determine the owner of an asset in Texas, we have to know how and when the asset was acquired. In general, all assets acquired by either spouse during the marriage while living in Texas are going to be community property, except for gifts and inheritances and assets acquired with property owned before marriage. For example, a married couple may have two vehicles: a truck titled in the husband's sole name and a sedan titled in the wife's sole name. Suppose that both cars were purchased during the marriage using community property, such as amounts out of the husband's salary or the wife's salary or accumulated salary in their joint account. Unless there is clear evidence of a gift, despite the fact that the truck is titled in the husband's sole name, it is still community property. If the husband writes his own Will and leaves the truck to his son from his prior marriage, he is attempting to dispose of more than what he owns. He only owns ½ of the truck. His wife owns the other ½ of the truck. Attempting to dispose of something owned by someone else can cause all kinds of problems, including federal gift tax problems, for the co-owner. Thus, if the husband dies and his wife does not challenge that specific bequest in the husband's Will, the wife has made a gift of her ½ of the truck to the husband's son from his prior marriage. If that gift (i.e., the wife's ½ of the truck) has a value exceeding $14,000, then it's a taxable gift, reportable to the IRS in a US Gift Tax Return (Form 709).

6. Creating Trusts for Will Beneficiaries. Many lay people write Wills that attempt to create a trust for one or more beneficiaries. Of course, there are many beneficiaries who should *not* receive their share of the Testator's estate outright, such as minors (persons under 18), mentally incapacitated persons, and "spendthrifts." However, lay people do not have sufficient legal training to draft a trust correctly. Drafting a trust correctly is even harder than drafting a Will correctly. There are many adverse effects of an improperly drafted trust, including the need to have a court "construe" the terms of the trust (legally interpret the wording) and modify the terms of the trust (change the terms of the trust because the way the trust was drafted will cause various problems, including serious tax problems). It is very expensive to have a Court construe and/or modify a trust. So, if a beneficiary's share of the Testator's estate needs to be held in a trust, the Testator should hire an attorney to prepare his Will and the trust for that beneficiary.

Bottom Line: A lay person should generally not write his own Will.

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Some Relevant 2015 Tax Figures.

Estate, Gift and GST Exclusion Amount: $5,430,000 (up from $5,340,000 in 2014)
Estate, Gift and GST Tax Rate: 40% (no change from 2014)
Annual Gift Tax Exclusion Amount: $14,000 (no change from 2014)
Annual Gift Tax Exclusion Amount for Gifts to a Spouse who is not a US citizen: $147,000 (up from $145,000 in 2014)

Estate Planning Check Up. If (i) you are married (and neither spouse has a child or children from a prior marriage), (ii) you have pre-2013 Wills or a Joint Revocable Trust that creates a Bypass Trust on the death of the first spouse, and (iii) the value of the combined estate of you and your spouse is well below the estate tax exclusion amount (currently, $5,430,000), you and your spouse should come in for an estate planning check up to determine whether or not to keep your Bypass Trust estate plan. With the passage of the American Taxpayer Relief Act of 2012 in January 2013, there are now two (2) ways for married couples to obtain two (2) exemptions from the estate tax (if two (2) exemptions are needed). And, of course, with the much higher exemption amount, many couples no longer need two (2) exemptions to avoid paying estate taxes. Remember that, if the provisions in your Will or Living Trust create a Bypass Trust on the death of the first spouse, the Executor/Trustee (often the surviving spouse) cannot just ignore those provisions–the Bypass Trust will have to be set up and funded even if it's no longer necessary to have a Bypass Trust from a federal estate tax standpoint. So, it is important to revisit your estate plan periodically and, especially, if the provisions in the beginning of this section apply to you.

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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