Estate Planning Insights

A Quarterly Publication of

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Vol. 12, No. 3 **July 31, 2015**

COMPANY LAW – PART ONE

Relevant Federal Tax Law. Lawyers who specialize in estate planning and probate law (also referred to as "trusts and estates" law) should be thoroughly knowledgeable regarding the federal "transfer tax" laws. The *transfer tax* laws include the estate tax, gift tax, Generation-Skipping Transfer Tax, and special valuation rules. In addition, a trusts and estates specialist should be knowledgeable regarding various federal income tax laws, such as the income taxation of trusts and estates, the "minimum distribution rules" (the federal income tax rules that apply to distributions from qualified retirement plans and IRAs), and the federal income tax basis rules (relating to the adjustment to the tax basis of capital assets on death). It also helps to know something about the income taxation of corporations, partnerships and LLCs because clients often own interests in these business entities.

Per one report, there are now over 26,300 pages in the federal "Tax Code" (the Internal Revenue Code itself and the "interpretive" Treasury Regulations). That figure does not even include all of the federal tax court cases and rulings issued by the IRS. So, it really does take many years to become an expert in the federal tax laws that are implicated in an estate planning and probate practice.

Applicable State Law. An estate planning and probate lawyer also needs to know a wide variety of applicable state laws. In addition to having a state Constitution, Texas has both statutory law (rules set out in various codes) and case law (decisions of state courts that interpret the law). Thus, a Texas lawyer specializing in estate planning and probate law needs to know the rules in various Texas codes, such as (i) the Estates Code, which includes provisions relating to decedents' estates, guardianships, multi-party accounts, financial powers of attorney, disclaimers, assignments, "descent and distribution," heirship determinations, the requirements for creating a valid Will, the "construction" (interpretation) of Wills, the procedures for both dependent and independent estate administrations, and creditors' claims; (ii) the Family Code (which includes rules relating to the marital property characterization of assets [as community property or separate property or partly both] and the liability rules applicable to married persons and their assets, both during life and upon death); (iii) the Property Code, which includes provisions relating to exempt property and liens, as well as the very extensive provisions of the Texas Trust Code, which includes (for example) the Uniform Principal and Income Act and the Uniform Prudent Investor Act; (iv) the Health & Safety Code, which includes provisions relating to Directives to Physicians (Living Wills) and Medical Powers of Attorney; and (v) the Texas Tax Code (which includes provisions relating to property tax exemptions). In addition, the specialist needs to know how the Texas Supreme Court and other Texas Courts have ruled on issues relating to estates, trusts, marital property law, guardianships, powers of attorney, etc.

The Duties of Transparency and Consistency. While both the state laws and federal tax laws are overwhelmingly voluminous, at least those laws are available for everyone to see. There is a duty of transparency with respect to most laws in the US. The laws are in written form and are in the "public domain." In addition, there is a basic "duty of consistency" applicable to both state law and federal law. The duty of consistency means that applicable law must be applied consistently to persons in the same situation involving the same facts. The duty of consistency promotes fair and equal treatment and adds a welcome degree of certainty for the lawyer specializing in the field of estate planning and probate law.

Company Law. One would assume that, after mastering all of the relevant state and federal tax laws, a trusts and estates lawyer would be able to help her clients in an efficient manner, without having to conduct extensive research (a moderate amount of research is always needed because state and federal laws are changed periodically, either due to legislative action, administrative rulings or court decisions). However, simply mastering state and federal laws relevant to an estate planning and probate practice is not sufficient any more. That is because the various companies where clients have assets and accounts and the companies where clients work (or have worked in the past) all have their own "rules" and "policies" and "procedures." Because these rules, policies and procedures have as much (if not more) effect on clients as state and federal law, I am going to refer to them, collectively, as "company law." There is no way that an estate planning and probate lawyer can ever "master" company law, especially since company law does not have to be consistent with state and federal law or with the law of any other company or necessarily applied consistently to all of that company's customers. Further, company law is far from transparent.

Over the past 34 years, company law has proliferated. One could speculate on the reasons for this (and there are probably multiple reasons). Whatever the reason(s), it is certainly simpler for companies to just "make up their own rules." Company law is often "quirky" and, worse, "problematic" from a legal standpoint. Dealing with company law is very frustrating for us and for our clients. It also causes clients to incur "extra" legal fees.

We are going to discuss three (3) recent cases involving company law--two (2) in this newsletter and one (1) in our next newsletter.

Power of Attorney Case. A "Client" was appointed as "attorney-in-fact" in each of her parents' financial durable powers of attorney. Using the technical verbiage, each parent is the "principal" and the Client is the "agent" in that parent's power of attorney (POA). The POAs are valid legal documents under applicable state law. Each POA became effective upon "execution" (i.e., as soon as the principal signed the POA in the presence of the notary and the notary completed the notarial acknowledgment).

The Client's father is now 87 years old and is in the mid to late stages of Alzheimer's disease. The Client's mother is 84 years old and still mentally "with it," but no longer interested in culling through the huge amount of mail received each day, paying all the bills, putting together the information needed by their accountant for their income tax returns, making significant investment decisions, etc. Although the Client's mother still goes to the grocery store, gas station and hair dresser, and still drives both herself and the Client's father to various doctor appointments, she is ready for the Client to take over the management of *all* of their financial affairs, including opening all the mail and paying all the bills.

The Client began contacting (i) the 2 banks and 3 brokerage firms where her parents had accounts, (ii) the 6 companies paying monthly pensions and annuities to her parents, and (iii) the 30-40 companies that regularly provide goods and services to her parents (utility companies, credit card companies, department stores, gas stations, pharmacies, doctors' offices, insurance companies, etc.) to inform them that she is now acting as her parents' financial agent under their POAs and to ask them to start sending account statements, transaction confirmations, correspondence and bills directly to her. In addition, because the Client did not know who ALL of the companies were that her parents were dealing with, and because her mother simply did not want to deal with the mail anymore, the Client submitted a change of address form to the US Postal Service, so that all of her parents' mail would be forwarded to her.

The Client first called each company to inform them of the situation and to find out what that company would require in order to begin sending all correspondence to her. Then she prepared and sent letters to each company, enclosing copies of the particular items requested. Many companies just asked for copies of her parents' executed POAs, as well as identifying and contact information for the Client. Some of the vendors and service providers didn't even ask for copies of the POAs--they just changed the billing address on the parents' billing accounts to the Client's address (they seemed to be happy for anyone to pay their bills). Other companies asked for the items noted above, but also had their own "forms" to complete. Some of those forms were simple one page forms that were not "too invasive" and did not have to be notarized, while other forms were anywhere from 4-7 pages in length and asked for a lot of information and required notarization.

Some companies where the Client's parents had accounts wanted the parents to complete and execute that company's own power of attorney "forms." EDITORIAL COMMENT: No one should sign a power of attorney form prepared by a company without first obtaining legal advice. A power of attorney prepared by a company is a legal document that is prepared by the company's lawyers on behalf of the company (i.e., for the benefit of the company), and not on behalf of the customer. It is even possible to take the position that when a company presents a power of attorney (or other legal document) that its lawyers have prepared to a customer, and the company is receiving fees from that customer pursuant to its contract with him, requesting that customer to sign the company's power of attorney form amounts to the "unauthorized practice of law." (Note that the "unauthorized practice of law" has a broader definition than simply non-lawyers preparing legal documents.) To understand the *unauthorized* practice of law, first consider the authorized practice of law. The authorized practice of law involves an attorney meeting with a particular client to discover his particular facts and circumstances and to determine his particular needs and desires and, based on that client's particular situation and the attorney's expertise, experience and judgment, the attorney may then prepare one or more legal documents that will be appropriate for that particular client (and/or may provide appropriate legal advice and counsel to that client). Thus, when a company gives its customers its power of attorney "form" (or other legal documents), which its lawyers have prepared, that is *encroaching* on the practice of law and is inappropriate (in our opinion). [End of editorial comment]

One brokerage firm where the Client's parents had accounts imposed this company law: account statements and other written items relating to her parents' accounts could not be mailed directly to the Client *unless* copies of those same items were mailed to another person as well. Yikes! And while the packages from this brokerage firm relating to her parents' accounts were reaching the Client due to the change of address on file with the U.S. Postal Service, the forwarded packages usually arrived 2-3 weeks "late" and the Client was concerned about what would happen when the forwarding order expired. However, the Client was "stuck with" company law.

Theoretically, one set of correspondence from this brokerage firm could have been sent to the Client's mother as the additional person, but that package would have ended up with the Client due to the change of address order on file with the Post Office. At any rate, that proposal was deemed not to comply with company law. Thus, after obtaining her mother's permission, the Client authorized the brokerage firm to send monthly account statements, transaction confirmations and other items relating to her parents' accounts to both the Client and the Client's brother (1 of her parents' other 3 children). If the Client's mother had not authorized this, the Client would have *breached her fiduciary duty* as POA agent to keep her parents' financial information confidential. [And what if both parents had been mentally incapacitated and could not give their consent?] It did not matter that applicable state law provides that an agent under a financial POA has the absolute right (and the duty!) to obtain all of the principal's account information--the law of the brokerage firm trumped otherwise applicable state law.

<u>Decedent's Estate Case</u>. During the same time period when the Client in the prior case was having trouble getting her parents' brokerage account statements sent to her as the agent under her parents' POAs, another client (the "Wife") was having trouble with the <u>same</u> brokerage firm. In this second case, the husband died leaving a Will that had been executed in 1998, which created a Bypass Trust. The husband's Will was filed for probate, along with an Application requesting the Court to appoint the Wife as Executor of the Estate. Upon conclusion of the probate hearing, the Court "admitted the husband's Will to probate" (i.e., declared the Will to be valid) and officially appointed the Wife as Independent Executor of the husband's Estate. Fancy pieces of paper called, "Letters Testamentary," were issued to the Wife, providing clear evidence of the Wife's authority to assume control of all of the husband's assets and to administer the husband's Estate.

Sometime prior to the probate hearing, however, the brokerage firm learned of the husband's death and "froze" the couple's joint account, which was titled as "Tenants in Common" (TIC). The TIC account contained both cash and stock, all of which was community property. It was the primary "checking account" used by the couple and automatic payments were scheduled to be deducted from the account, which were now at risk of "bouncing."

The account was appropriately titled as TIC and not as "joint tenants with right of survivorship" (JTWROS) in this case because the couple wanted the community ½ interest in the account owned by the first spouse to die to pass into the Bypass Trust created in the first spouse's Will upon his/her death. Remember that, in 1998 (when the couple's estate plan was made), the exemption from the federal estate tax (the "death tax") was only $625,000 and the top estate tax rate was 55%. The couple did not want to pay estate taxes on everything above $625,000 when the surviving spouse died. So, their Wills included provisions for a Bypass Trust, doubling the amount protected from estate tax.

For a Bypass Trust to be effective, (i) both Wills must contain provisions creating it, effective on the first spouse's death, and (ii) the first spouse's ½ interest in the account has to be able to "make it into" the trust upon his/her death. If the account in this case had been titled as JTWROS, *none of it could have been placed in the Bypass Trust when the husband died*. That is because assets in a JTWROS account pass directly, <u>outside</u> <u>the Will</u>, to the surviving spouse. The spouse then becomes the owner of those assets. If a surviving spouse places assets that she owns into the Bypass Trust, that eliminates the estate tax avoidance feature of the Bypass Trust. *The Executor of the first spouse's estate must have "legal control" over the assets in order to place them into a Bypass Trust* (or Marital Trust or any other trust created in the decedent's Will). Thus, the TIC title was correct.

Pursuant to applicable state law, the TIC account should have been "unfrozen" as soon as the Wife presented Letters Testamentary to the brokerage firm, but it wasn't. The Letters Testamentary issued to the Wife clearly indicated her right to access and control the husband's community ½ interest in the TIC account as the Executor of his estate. And, of course, the Wife already owned the other ½ interest in the TIC account, so the brokerage firm should not have prevented her from accessing assets that she owned in her own right. However, even after the Wife presented Letters Testamentary to the brokerage firm, the TIC account remained "frozen" for weeks!

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In this case, to "unfreeze" the account, company law required the Wife to provide the brokerage firm with copies of income tax returns for several years, a list of debts and expenses paid after death, written instructions for the distribution of the account, plus a whole lot of other information not required by state law to "unfreeze" the account. Plus, under applicable state law, the Executor has the right (and the duty!) to take control of the decedent's assets as soon as possible. It took a written legal opinion and the threat of a FINRA action to get the brokerage firm to "un-freeze" the TIC account in this case. Unfortunately, company law caused thousands of dollars in additional legal fees.

There are two lessons to be learned from the two cases discussed in this newsletter. First, now that the American Taxpayer Relief Act (passed in January 2013) has increased the estate tax exemption amount to $5 million, indexed for inflation ($5,430,000 in 2015) and has added a second way for married couples to obtain 2 exemptions from the federal estate tax (portability), couples with estate plans that were created prior to 2013 should come in for "an estate planning check up." For some clients, it may be appropriate to obtain new Wills and to re-title accounts and complete new beneficiary designation forms. There is no "one size fits all estate plan," however, so it is necessary to come in for a consultation to see what is appropriate for you, based on your particular circumstances.

The second lesson is this: many companies have their own laws that may well override otherwise applicable law and some of those laws are "problematic." On the other hand, some companies do follow applicable law and are relatively easy to deal with when an account owner dies or loses his mental capacity. Not all companies are the same! So, it would be a good idea to determine, now, what company law will apply when you die or become mentally incapacitated. What will the agent in your POA and the Executor in your Will (or Trustee of your Living Trust) have to do, *exactly*, to gain control of your assets and accounts when necessary?

Stay Tuned for Part Two!

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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