# ESTATE PLANNING TODAY

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# Frequently Confused Matters

*Having a Will is an essential part of a good estate plan. The best Will in the world is not enough, though, if you don't take extra steps to coordinate the titles of your financial accounts and the beneficiary designations on life insurance and retirement plans. Unfortunately, many clients are confused about the difference between account titling and beneficiary designations. Other sources of confusion include the use of Medical Powers of Attorney vs. Living Wills, the effective date of financial powers of attorney, and the use of some common estate tax terminology.*

## Titling of Accounts/Wording of Beneficiary Designations

Well designed estate plans implemented in documents such as Wills and Revocable Trusts (also known as "Living Trusts") can be made ineffective by clients' failure to do their "homework" after the documents are signed in two related, but separate, matters. One is the proper titling of accounts. The other is the proper wording of the primary and contingent beneficiary in a beneficiary designation form. Generally, your Will or Living Trust Agreement should contain your "master" estate plan; as many of your assets as possible should flow through that document and be part of the "master" plan. This approach ensures that your estate plan will be effective no matter what contingencies arise, and also maximizes tax benefits. Some forms of asset titling cause the asset to pass outside of the estate plan contained in the Will or Living Trust. Other assets *always* pass by beneficiary designation rather than by the terms of the Will or Living Trust and, therefore, specific wording must be used in the beneficiary designation forms so that those assets can be coordinated with your estate plan. People often confuse the issue of the proper titling of assets (particularly the titling of bank, brokerage and investment accounts) with the issue of wording beneficiary designations appropriately.

Accounts that are titled as joint tenants with right of survivorship ("JTWROS") or as payable on death ("POD") or transfer on death ("TOD") pass at death outside of the account owner's Will or Living Trust. With respect to most bank accounts, brokerage accounts, mutual fund accounts and other "after tax" investment accounts, it is possible to designate some form of survivorship or beneficiary; however, it is generally not wise to do so.

Other assets, such as life insurance policies, IRAs, qualified retirement plans and commercial annuities, pass upon a person's death according to the beneficiary designation form on file with the company. There is no option. A beneficiary must be designated on the beneficiary designation form provided by the insurance company, IRA custodian or plan administrator. The task of coordinating these assets with a person's estate plan usually involves obtaining forms from the particular financial institution or sponsoring company. The actual steps involved can differ in the transfer mechanism that applies.

As our clients know, whenever we do estate planning, we provide written instructions regarding (i) the proper titling of accounts–and especially the forms of account/asset titling to avoid; and (ii) the proper wording for the client's beneficiary designations. Many married couples have joint accounts at banks, credit unions, brokerage firms, mutual fund companies and investment houses. They are often told by the financial institution that their joint account *must* be titled as "joint tenants with right of survivorship" ("JTWROS"). This is not a legal requirement but may be merely the administrative policy of the particular financial institution. In addition, couples are also sometimes

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advised that if they do not title the account to include rights of survivorship, the surviving spouse will not be able to have access to the account after the first spouse dies. This is simply not true under Texas law. Even without the survivorship feature, a joint owner of an account continues to have full access to the account due to being named on the account as a co-owner. Including a survivorship feature on a joint account is not necessary for access to the funds in the account. To the contrary, it can be detrimental, since it overrides the disposition in the Will of the first spouse who dies.

The confusion that clients often have with respect to the "homework assignment" given to them by their estate planning attorney is which assets need to have a beneficiary designation and which assets need to be retitled to avoid improper survivorship titling. As noted previously, proper beneficiary designations are necessary in all cases where a beneficiary designation is the *required* form of transfer upon death, such as is the case with life insurance policies, IRAs, qualified retirement plans, and commercial annuities. In the case of all other accounts and assets, even though providing a beneficiary may be an *option* allowed by the financial institution, we usually recommend that you not place a beneficiary on "regular" accounts and not allow a joint account to be titled as joint tenants with right of survivorship.

## Medical Durable Power of Attorney/ Directive to Physicians

Most estate planning clients sign two different but related forms that deal with medical treatment decisions. Frequently, people are confused about the purposes of and differences between (i) a Medical Durable Power of Attorney; and (ii) a Directive to Physicians or Family and Surrogates (also called a "Living Will"). Basically, a Medical Durable Power of Attorney allows you to name another person to make medical decisions for you in the event you are unable to make or communicate medical decisions yourself (due, for example, to unconsciousness, mental incapacity from an accident, or stroke). This decision making authority relates to any number of medical treatments for which the patient's informed consent is required.

A Living Will, on the other hand, relates to only one particular medical decision, namely, the extreme situation involving a "terminal illness" or an "irreversible condition" which reaches the point where you are no longer able to enjoy a meaningful life. If you sign a Living Will, you may select as one of the alternatives a provision indicating that you do not want life sustaining treatment, such as mechanical means of support, to artificially prolong your life if you have reached that point of physical decline. (The Texas Living Will form also allows you to select the opposite alternative.) Most people who sign the Living Will are concerned with the type of situation exemplified by the Karen Quinlan case. Karen Quinlan was a young woman who, as a result of ingesting drugs and alcohol, was left in a persistent vegetative state, although physically her body was still quite healthy. She was placed on a respirator by the hospital to which she was taken due to her emergency situation. Her family spent over 11 years thereafter in court proceedings, trying to have her removed from life support. The courts were initially unable to grant the family's request because Karen Quinlan had not indicated, by signing a Living Will or other advanced directive for herself, her wishes about life support; the doctors and hospital had no choice but to continue to maintain her life.

The current Texas Directive to Physicians form allows an individual to indicate a preference about withholding or not withholding life support in the situations of a terminal condition and an irreversible condition. The form as now written for the first time specifically allows people to indicate that they *do* want life support. Most people, however, who sign a Living Will do not want to be artificially maintained when they do not have any reasonable probability for a sentient life.

If someone has both a Living Will and a Medical Durable Power of Attorney, the Living Will actually takes priority over the Medical Power of Attorney. This is because the Living Will is a statement of your own intentions, while a Medical Power of Attorney names another person as your surrogate to do his or her best to make the decisions they think that you would make.

The law always gives you first priority to make your own medical decisions as long as you are able to make and communicate them, without regard to whether you have signed a Living Will or Medical Power of Attorney. However, if you become unable to make or communicate a medical decision, then your medical agent would begin acting on your behalf under the Medical Power of Attorney. If you have a terminal illness or an irreversible condition (as certified by your attending physician), the Living Will is triggered, and your agent under your Medical Power of Attorney cannot countermand your instructions as expressed in your Living Will. You may prefer *not* to provide your Living Will to a hospital or clinic upon admittance for an operation or other procedure, but to keep the Living Will in a safe place to which your family or medical agent has access. That way, you continue to make your own medical decisions

for as long as possible. If you become unable to do so, because the medical provider does not have a copy of your Living Will, they will then discuss your situation with the medical agent you have named in your Medical Power of Attorney. This approach gives you, through your trusted agent, further control over when your Living Will actually becomes applicable. In other words, your medical agent can confer with your doctors and other family members and determine whether you have reached the condition where the Living Will would be triggered and, if so, your medical agent can then provide the Living Will to the hospital.

## The Statutory Durable (Financial) Power of Attorney: Effective Date Issue

The Texas Statutory Durable Power of Attorney form allows you to appoint someone as your agent to handle your property and financial affairs during a time when you are unable to do so (primarily due to mental incapacity). By having this form in place before you become mentally incapacitated, you can usually avoid the need for a guardianship in the probate court. Due to relatively recent amendments to the Durable Power of Attorney statute, you have a choice in Texas with respect to the "effective date" of your agent's powers: those powers can be effective either immediately upon execution of the Power of Attorney or only in the event you actually become (mentally) disabled or incapacitated. If you choose the latter, your Power of Attorney is referred to as a "springing" power of attorney. While the springing Power of Attorney may be best for some people, for a variety of reasons, many people prefer to make the Power of Attorney effective upon execution. First, there may be situations where the principal (the person granting the Power of Attorney) is merely unavailable, such as out of town for an extended period of time or physically laid up due to some accident. In such a case, it would be better to have a currently effective Power of Attorney so that the agent could pay bills, file tax returns, and handle other financial matters during that time, as directed by the principal, using the Statutory Durable Power of Attorney. In addition, if the principal has a sudden emergency, resulting in a sudden mental disability or incapacity, if the Power of Attorney is effective upon execution, the agent will be able to act immediately, while if the Power of Attorney is effective only upon mental incapacity or disability, there may be some delay before the agent is able to obtain a doctor's letter or other evidence of the principal's disability or incapacity. If the person you name as your agent is someone you trust without reservation (and that should always be the case), making the Power of Attorney effective upon execution, so that it is potentially more useful and easier to use in an emergency, is probably advantageous. If you are merely unavailable or physically disabled but not mentally incapacitated, you will be able to direct, supervise or review the actions taken by your financial agent. If you are mentally disabled or incapacitated, which is the situation where you *really* need to have a Statutory Durable Power of Attorney in place, you will, by definition, not be able to oversee what your agent is doing. Thus, assuming you trust your agent completely (an absolute prerequisite for naming someone as your agent), you might well wish to make your Power of Attorney effective immediately.

## Marital Deduction vs. Use of Estate Tax Exemption

Many people are confused about various provisions in the estate tax laws. One of the biggest sources of confusion is the difference between the unlimited marital deduction for transfers made to spouses who are U.S. citizens and the estate tax exclusion amount. Most people are aware that transfers of unlimited amounts of assets can be made to a spouse who is a U.S. citizen and not be subject to immediate gift or estate tax. Many people also know that the estate tax exclusion amount is currently $1 million per person, and the popular press often states that married couples can thereby shelter $2 million from estate tax. What married couples often fail to realize, however, is that if the first spouse to die leaves everything *directly* to the surviving spouse, the first spouse's $1 million exemption cannot be used. Only the surviving spouse's exemption will be available upon his or her later death. In other words, use of the unlimited marital deduction, without further planning, results in wasting the first spouse's estate tax exclusion amount. This can make a tremendous difference in total taxes paid when the second spouse dies.

Theoretically, a married couple with exactly $2 million should be able to pass on their entire estate to their children estate tax-free. However, if the first spouse to die leaves his or her community one-half of the total ($1 million) directly to the surviving spouse, while no estate tax will be paid at the time of the first spouse's death, the surviving spouse will now be the owner of the entire $2 million estate. Thus, when the surviving spouse dies and passes on the $2 million amount to the couples' children, only $1 million of it (under current law) will be exempt from estate tax and the other $1 million will be subject to estate tax. The estate tax in that situation would be $435,000 under current law. As our clients know, in order not to waste the first spouse's

estate tax exclusion amount, we recommend using a device known as a "Bypass Trust."

Ordinarily, the surviving spouse will be the sole trustee of the Bypass Trust, giving the spouse control over investments and distributions from the trust. The surviving spouse will also usually be the primary beneficiary of the trust. That means that the assets in the Bypass Trust are available to help the surviving spouse maintain his or her accustomed standard of living. The Bypass Trust also can be structured to allow distributions to children or grandchildren (or to elderly parents or others) for their health, support, maintenance and education, as determined in the discretion of the trustee (the surviving spouse). In many respects, a Bypass Trust is merely a form of title/separate account that keeps the assets belonging to it segregated from the assets personally owned by the surviving spouse (thus ensuring avoidance of estate tax on the Bypass Trust assets at the surviving spouse's death). The assets in the Bypass Trust are still able to be used and enjoyed by the spouse (and descendants). The first spouse's estate tax exclusion is applied to the trust, and the assets in the trust (regardless of their value) are excluded from estate tax at the time of the surviving spouse's death. Thus, assuming a Bypass Trust is funded with the $1 million estate owned by the first spouse to die, and assuming the value of the assets owned directly by the surviving spouse does not change by the time of the second spouse's death, use of the Bypass Trust would enable the couple in the second situation to pass on their entire $2 million estate to their children totally free of estate tax.

## Contact Us:

Naturally, each estate is unique, and this brief overview should not be treated as a substitute for legal advice. You can reach us at the address and phone number shown below, or by e-mail:


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