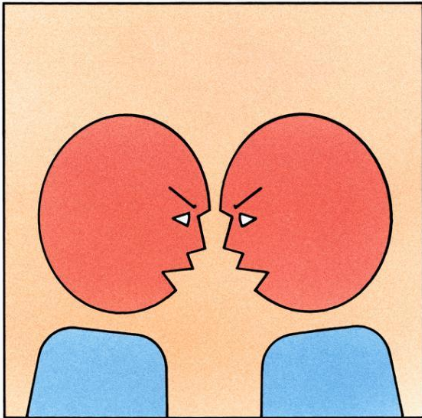
6 costly estate-planning minefields, and how to avoid them

ConsumerReports

April 15, 2015



Over the years many celebrities have provided cautionary estate-planning lessons, and actor James Gandolfini, who died in June 2013 at age 51, is no exception. The actor, known for portraying mob boss Tony Soprano, left a portion of his estate, widely estimated at $70 million, to relatives and friends through his will, which became public and was criticized as being badly constructed. For one thing, it exposed some of his wealth to probate, the time-consuming and potentially costly process a legal court takes to administer financial affairs. In addition, his estate could owe millions of dollars in federal estate tax alone.

At least Gandolfini had an estate plan; fewer and fewer Americans do. In 1998, 61 percent of Americans 55 and older had a will or trust. In 2012, only about 54 percent did, says a study by Texas Tech University.

Failing to take action or making the wrong moves can be costly for you and your heirs. Here are six blunders experts told us they see most often, and what to do instead:

Minefield No. 1: You think you're too young for a will or don't have enough assets to protect
A good estate plan can save your heirs some money; it also protects you and your family while you are alive. If you don't have a plan and you become incapacitated, someone will have to go to court to be named your guardian so that he can make medical and financial decisions for you. The process not only is unpleasant but also could easily cost $10,000 or more, says Martin Shenkman, a New York City attorney and certified public accountant. If other family members object, the process could drag out, which will cost more and could leave your bills unpaid or delay needed medical treatments.

If you die without a plan, you'll also have no control over who becomes the guardian of your minor children or who gets your assets. "A lot of people assume that if they do nothing, everything goes to a surviving spouse," says Deborah Cohn, an estate-planning attorney in Bethesda, Md. Instead, your property will pass to your survivors based on your state's laws of intestacy.

And if you have neglected to name beneficiaries on accounts that need them, such as retirement,life insurance, and brokerage accounts, the companies that manage those products have a default rule in their contracts' fine print that spells out how your assets will be distributed. "It might say it goes to your surviving spouse, but it might also say it goes into your probate estate," Cohn says. "Then your state's intestacy law make those decisions for you, and money will be depleted to pay for probate."

Steer clear. Get a basic estate plan in place. You'll need a will, which states who you want to inherit any property that does not have a designated beneficiary, and name a guardian to care for young children. You'll also want to draw up a financial power of attorney, which will allow someone you name to make financial decisions for you when you no longer can. Health care directives, which include a health care declaration (living will) and a power of attorney for health care, let someone make medical decisions for you. (In some states, those documents are combined into one, called an advance health care directive.) You may also want to consider a trust, which will hold some or all of your assets and pass them directly to your heirs at your death, avoiding probate.
Drafting a plan doesn't have to cost tens of thousands of dollars. You can do it yourself with document-writing software that costs less than $100. "DIY plans are better than nothing, but they won't address your individual needs," says Russell James, an estate-planning attorney and a professor in the department of personal financial planning at Texas Tech University. A basic plan drawn up by a pro can cost as little as $1,500 to $2,500, says Steve Hartnett, an estate-planning attorney and the director of education for the American Academy of Estate Planning Attorneys. But if your situation is more complicated (for example, you own a family business and will need to set a up a plan for a child with special needs), the cost could be several thousand dollars.

Search for an attorney who specializes in estate planning by getting a referral from your accountant or financial planner, or check the websites of the American College of Trust and Estate Counsel and the National Academy of Elder Law Attorneys. Then call a few and ask how much they'll charge, if anything, to meet with you for an hour and discuss your estate-planning needs. After your consultation, concentrate on negotiating the lowest price you can with the lawyers you like the best.

Minefield No. 2: You put everything in joint ownership

After a divorce or the death of one parent, the surviving parent often add a child's name (or that of another relative or friend) to bank, brokerage, property, and other assets as a way to ensure that they can take control if you need them to, and allow them to inherit the assets when you die and avoid probate, James says. "What parents often fail to grasp is that the child is a full co-owner of the asset immediately," he says. You may not be worried about your child or another person you trust misusing

the funds, but your worldly goods could be at risk if he is involved in a lawsuit, bankruptcy, or divorce proceeding.

Steer clear. You can designate who will inherit your bank accounts, vehicles, and real estate automatically when you die. For example, you can set up payable-on-death bank accounts. All you need to do is fill out a simple form, provided by the bank, naming the person you want to inherit the account. While you live, the person you named has no rights to the money. You can spend it, name a different beneficiary, or close the account. At your death, the beneficiary receives the funds directly, avoiding probate.

Almost every state has adopted a law (the Uniform Transfer-on-Death Securities Registration Act) that lets you name someone to inherit your stocks, bonds, and brokerage accounts without probate. It works very much like a payable-on-death bank account. You tell your stockbroker or the company itself that you'd like to take ownership in what's called "beneficiary form." Those you name have no rights to the asset as long as you are alive.

Several states also allow transfer-on-death deeds for vehicles. You can find a list of the states that allow those types of accounts on Nolo's website.

Minefield No. 3: You forget what a will doesn't do

One of the biggest misconceptions is that a will has the final word, James says. But if you have a 401(k), an IRA, insurance policies, and other assets with named beneficiaries, as well as the payable-on-death and transfer-on-death account mentioned above, that money will be distributed directly to the people named, even if your will states otherwise. So if your will says that you want your son to receive your life-insurance proceeds, but your ex-wife is still the beneficiary on record at the insurance company because you forgot to update your information, she gets the money.

Steer clear. Make a list of your assets with named beneficiaries, and review them at least every five years. Make sure that all documents still reflect your desires and that your beneficiaries and financial and health care proxies are still willing and able to serve. In addition, revisit your estate plan if Congress revises estate-tax laws or whenever there is a major change in your life, such as a birth, death, marriage, or divorce.

Minefield No. 4: You allow your legacy to be squandered

You may wish to leave property to a beneficiary but worry that he won't spend it wisely or that she might get into trouble with creditors. Even if you respect your heir's ability to handle money, he still might be tempted to spend it quickly. In a 2012 study, Jay Zagorsky, a researcher at Ohio State University's Center for Human Resource Research, found that the average baby boomer surveyed had spent, donated, or lost roughly half of his or her inheritance in the first 12 months.

Steer clear. If you are concerned, put the assets you want to pass on in a trust and include instructions on how and when it will be paid out. A spendthrift trust allows payments to the beneficiary on a regular basis (say, monthly), so it can't be spent all at once. Because the beneficiary cannot access the trust principal, neither can his creditors.
You could also set up a trust that pays funds out over time—say, when a child reaches ages 25, 30, and 40. Or you can say what the funds can be used for, such as educational expenses, a new home, or retirement savings.

Minefield No. 5: You ignite sibling rivalry
"When parents die, fights between siblings are often over things, not money," Cohn says. Jewelry, furniture, artwork—the legal term is "nontitled property"—and who gets what is often the biggest source of unhappiness among surviving family members.

Steer clear. Talk to your children to find out what they want and expect. "Parents have to be skillful in setting the tone," Cohn says. "If you are asking for honest answers, you have to be willing to hear them."

Of course, you'll have to make the ultimate decisions. So if you want your jewelry or paintings to go to a particular child, put it in writing. Many states let you attach a codicil to your will indicating that you've made a separate list distributing your possessions. You can update the codicil without having to update your will when you do.

Minefield No. 6: You overcomplicate your plan
The federal estate- and gift-tax exemption is $5.43 million in 2015, up from $600,000 in 1997; it continues to increase with inflation each year. Spouses may combine exemptions, so they can leave or give away $10.86 million this year without their heirs owing federal estate tax (which can be as high as 40 percent). The Tax Policy Center estimates that just 0.14 percent of estates in 2014 owed federal estate tax, down from 2.3 percent in 1999 and 7.65 percent in 1976.

When the limits were lower, many married couples funded complex plans that often included a bypass trust to take full advantage of the estate exemption. The trust would include as much of the deceased spouse's property that he could pass free of estate tax using his exclusion. The surviving spouse would often have access to the income from and the principal of the bypass trust during her life, but the bypass trust would not be part of the surviving spouse's estate at death and would pass estate-tax-free to the beneficiaries.

In 2011 the law changed to make the deceased spouse's exemption portable, offering couples the option to jettison the trust to avoid its drawbacks. For example, assets in a bypass trust won't get a step-up in basis at the death of the second spouse, so the heirs could face big capital gains bills on appreciated assets. Depending on where you and your intended beneficiaries live, the income-tax savings from the step-up in basis may be greater than the estate-tax cost.

In addition, unless trust income is distributed, the income-tax penalty can be huge. That's because a trust hits the highest income-tax bracket once it has more than $12,150 of taxable income. By contrast, a single individual doesn't hit that bracket until his taxable income is more than $406,750.

Steer clear. You're not likely to need a bypass trust to use both spouses' exclusions. But if you already have one set up, talk to your attorney about what to do. Depending on your situation, you may still find a bypass trust worthwhile if you want to protect assets from creditors or ensure (in the case of a surviving spouse's second marriage) that the money eventually goes to your own children.

This article also appeared in the March, 2015 issue of *Consumer Reports Money Adviser*.