The 10 Costliest Estate Planning Mistakes and How to Avoid Them

by James A. Hyatt, Attorney at Law

Based on my 28 years of assisting clients with their estate planning, and cleaning up messes left behind by those who died without having properly planned for their families, I have gathered together what I consider to be the most important lessons and advice that I can share. My hope is that by sharing this essential information, more families can be spared the difficulties that can otherwise be avoided by proper planning.

Essentially, the costliest estate planning mistakes have two causes:

(1) lack of knowledge; and

(2) lack of action.

This booklet provides you with information that will enable you to avoid the mistakes and show you how to avoid the pitfalls if you take the steps necessary to protect yourself and your loved ones. *But, the motivation to lead you to take those steps will have to come from **you***. It is my hope that this brief overview of common mistakes will inspire and motivate you to initiate your estate planning.

At The Law Office of James A. Hyatt & Associates, our mantra is **Estate Planning Matters**. By this we mean that it really makes a difference. The difference between planning properly and not planning properly is the tremendous effect that action versus inaction will have on those who will be directly affected by your disability or death.

The "Ten Costliest Estate Planning Mistakes":

1. Trying to "keep it simple."

I can't even count the number of times someone has called my office and said something like, *"I just need a simple will – how much will that cost me?"* To me, that translates to: *"My spouse and my kids are nothing special, and I don't want to spend much time or money creating the plans necessary to protect them; so, what's the minimum amount of effort and money I need to put into this?"* It makes me wonder – if they were building a house, would they ask the builder, *"I just want something that won't fall down. So, how much will I have to spend?"*

There are plenty of do-it-yourself books and software on the market that purport to enable you to do all of your estate planning without hiring an attorney. These can save a lot of money – for the person using them. So it means less money out of the pockets of lawyers like me. But unfortunately for that person's family (and fortunately for lawyers like me) the savings pale in comparison to the amount that a lawyer will make when that person dies and his loved ones need to hire an attorney to clean up the mess left behind.

And if you "shop" for an attorney by calling and just asking about prices, chances are you will end up selecting a general practice lawyer who can write a "simple will" that consists only of word processing the directions you give him. This leaves out the counseling that an experienced estate planning lawyer can bring to the table. As we will see in the discussion below, there are a lot of reasons why "simple" is not "good." And in many cases, for tax reasons, and especially in second-marriage situations, "simple" wills can be a disaster. It's unfortunate, but the reality is that the tax laws are complicated. Thus, much of the planning necessary to navigate these laws is not "simple". But with the assistance of an experienced estate planning attorney, you can put together an estate plan without having to learn all the laws yourself.

One other point about the urge to "keep it simple." Let's look at what "estate planning" really is. In many ways, your estate planning documents (your Last Will and Testament or Living Trust) are your written legacy to the people you care about most. These documents speak to your loved ones after you can no longer do so yourself. Do you want these to be dry, "bare bones" or "fill-in-the-blanks forms that say to your loved ones: "I didn't want to spend much time or money on this, and if you have problems after I'm gone, well, it doesn't matter to me because I won't be here?" Or do you want your family to be thankful that you loved them enough to plan properly so that they are protected from unnecessary cost, delay, aggravation and disputes?

> *The lesson: If your family is important to you, then your estate planning should deserve the investment of your time, effort and money. Work with an experienced attorney who focuses on estate planning, and resolve to do it right. Your family will appreciate it.*

2. Not considering the implications of Joint Titling.

If you are married, there's a good chance that most, if not all, of your property and assets are titled with your spouse, jointly. In many cases, that's not a problem. However, depending on the total value of your combined estate, it can create costly tax problems, as discussed below in Item # 5. If this is not your first marriage, and you have children from a prior relationship, it can possibly have even more serious consequences.

The bottom line: jointly-titled property can be problematic because when property is held jointly there is no way to plan for the disposition of the asset at your death. When you are married, the rule of *survivorship* applies – that is, the property automatically passes to the other joint owner immediately at your death. It doesn't matter what it says in your will or trust, because your will or trust does not apply to any jointly-owned property you may have.

Married couples with a combined estate (including life insurance) in excess of $1 million with all assets titled jointly will almost certainly leave their heirs with an estate tax bill to pay. By creating a proper estate plan, and re-titling some of the joint assets in the spouses' separate names, that tax can be avoided.

Property owned jointly by spouses in a second marriage poses a real recipe for disaster, since whoever lives the longest will own the entire account or property. Thus, if each spouse has their own children, the children of the spouse who dies first will probably get left out in the cold.

Another problem which we see arise with jointly-titled property is when elderly parents (usually the surviving spouse) put one of their children on their accounts as a joint owner, thinking that this will make it easier for that child to have access to the funds if the parent becomes incapacitated or that when the parent dies, the assets won't have to go through probate. While that may be true, doing so also puts the parent's assets at risk if the child divorces, is sued, or goes bankrupt. We also see problems when a parent puts one child's name on an account, but they have other children with whom they expect the one child to share the account after the parent dies. This creates several potential problems, including the possibility that the named child, after learning that he or she has now become the legal owner of the account, without any legal obligation to share the money, decides that "Dad" really wanted her to keep it all and not share it with her siblings. Thus, the other children get left out in the cold, with no legal right to claim their share of the money. Even if the child does decide to do the right thing and "share" it with her siblings, she will be surprised to discover that under the tax laws, if she does share this money, she will be making a taxable gift. If the money involved in such an arrangement is significant, the tax problems created by using joint-titling to avoid probate can be substantial.

The lesson: Don't title property in joint names without fully considering the consequences.

3. Failing to make the right beneficiary designations.

For many people, much of their wealth consists of life insurance and retirement benefits. The disposition of these assets at death is directed by beneficiary designation. One of costliest mistakes we find people make is a failure to pay sufficient attention to completing these beneficiary designation forms properly *and* keeping them current. Careful consideration must be paid to ensure that the beneficiary designations are properly coordinated with your will or revocable trust. Also, since these assets are often the most valuable part of your estate, the opportunities to avoid or minimize estate and income taxes must be carefully considered.

One very common problem we see relates to parents with young children. Most often, these young people have absolutely no estate planning documents. Obviously, that is cause enough for concern. The most significant consequence is that the children will get their inheritance upon reaching age 18. How many parents would want their children, at age 18, to have the family wealth handed to them with no strings attached?

But even if the parents have been astute enough to do some estate planning – including providing through their will or Living Trust for a trust that would allow an aunt or uncle or some other person as Trustee to manage the money and oversee distributions for the child's health, education and support until the child reaches sufficient maturity, in order for those insurance proceeds to get into the trust, the proper beneficiary designation form must be filed and accepted by the insurance company. The beneficiary designation form needs to specifically name the will or trust as beneficiary. Otherwise, the life insurance will be paid to a court-appointed guardian, who will be forced to hand over what remains of the money to the child when the child reaches the age of eighteen. Without taking that extra step of properly making the beneficiary designation for the life insurance and retirement benefits, the will does not achieve the parent's goal – so it's not worth the paper it was written on.

When it comes to retirement accounts (i.e., IRAs, 401(k) plans, etc.) beneficiary designations are especially important, since there are not only estate tax implications, but income tax consequences as well. The IRS rules relating to the income tax treatment of retirement benefits are quite complex, but the benefits of properly navigating those rules can be staggering. In general, it pays to "stretch out" the distributions over as long a period as possible, so as to take advantage of the tax-deferred environment that applies to retirement benefits. The best vehicles for maximizing the tax deferral are the spousal rollover and the minimum distribution rules. Each person's situation is unique, though, so it is important that the beneficiary designations be designed to fit the circumstances. For example, in a second marriage situation, where each spouse has his and her own children, a spousal rollover is probably not appropriate, since it will likely result in the disinheritance of the children of the IRA owner. A spousal rollover also might create a future estate tax liability that could otherwise be avoided. Also, where trusts are named as beneficiaries of the IRA, they must be carefully designed in order to qualify for "stretch out" treatment – otherwise a huge income tax liability may be created.

The lesson: Beneficiary designations are critically important and must be carefully coordinated with your estate planning documents.

4. Not choosing (and preparing) the right successors.

When you prepare a will or trust, there are going to be some *key players* you will need to designate to carry out your wishes. The first of these key players is the ***Personal Representative***. This is the person who will be charged with the legal responsibility to file the will and carry out the administration of the estate, including seeing that any debts, expenses and taxes are paid, and that the property is distributed in accordance with the terms of the will. This is a big job, with much responsibility and power. If the person you designate as Personal Representative is not well-equipped with the skills and dedication necessary to carry out their responsibilities, many problems will result, including: delay, added expense, missed opportunities to save taxes, friction among family members, etc.

If you have minor children, your will should designate a ***Guardian***. This is the person who will have ***legal*** custody of your children and will be responsible for their upbringing. Considerable thought should be given to the guardian selection. Does this person share the values you want instilled in your children? Is their lifestyle compatible? Will the children be able to stay in the community they are accustomed to? Most importantly, have you been given assurances from the person or couple that they would be willing to undertake the responsibility of raising your children?

Where your estate plan includes trusts (as most plans should) you will need to designate successor ***Trustees***. A Trustee is a person you designate to be in charge of the trusts that you establish. Their job is to manage the trust property and use the funds to support the beneficiary. The beneficiary may be your spouse, minor children, adult children or any other person you want to benefit. The law imposes on a Trustee a fiduciary duty to carefully follow the instructions included in the trust document for the support and maintenance of the beneficiary. Thus, the Trustee's actions may be scrutinized by a Court if any beneficiary is disgruntled. A Trustee will need to keep good records, file income tax returns, decide on investment options, and often need to make difficult decisions on what distributions to make. Not all people are well-equipped to

handle such a job, so it is important that you select the right person. Also, it helps if the person you designate as Trustee is prepared for the job. It is recommended that you share your thoughts about how you envision the Trust being administered, especially when the Trust vests a wide degree of discretion with the Trustee. We often will recommend that our clients bring their successor Trustees in for a "Trustee Training Workshop" so we can let them know what to expect, and better prepare them for the duties they will be facing.

> *The lesson: Carefully consider who will be your key decision-makers and get them prepared for the job.*

5. Missing opportunities to reduce or eliminate taxes.

If the total estate of a decedent exceeds a certain amount, federal and state estate taxes are imposed. Even though the threshold level for taxable estates has increased dramatically over the past several years, many estates can be hit with these taxes and the consequences can be severe – such as the federal estate tax rate of 45%. Currently only estates that exceed $3.5 million are subject to federal estate tax. Maryland, however, imposes an estate tax on estates over $1 million. One often overlooked fact (and it can be a costly mistake) is that the face amount of life insurance payable at death is included in the taxable estate. Married couples can easily avoid any estate taxes at the death of the first spouse, due to an unlimited marital deduction. However, unless special provisions are built in to the estate planning documents to make use of both spouses' tax exemption (and other steps, including placing assets in each spouse's individual name, are taken) then the children or other heirs may be hit with estate taxes if the total estate exceeds $1 million.

With federal estate tax rates of 45%, a married couple with a $7 million estate can leave an estate tax bill of $1,575,000 for their children if they fail to plan properly. With a proper plan, that tax bill can be completely eliminated.

Where the total estate value exceeds the applicable exemption limits, there are a number of more advanced planning opportunities (for example, Family Limited Partnerships, Grantor Retained Trusts, Charitable Remainder and Lead Trusts, Spousal Access Trusts and Irrevocable Life Insurance Trusts) that can save thousands, even millions, in estate taxes. These are sophisticated techniques that require the guidance of an experienced estate planning attorney.

> *The lesson: For estates over $1 million, it is especially important to pay attention to the tax consequences of your estate plan, to ensure that any unnecessary taxes can be avoided.*

***6. Failing to plan for disability*.**

Many people view estate planning, or "drawing up a will" as something you do in case you die. While that is partially true, it leaves out a big reason for planning your estate – taking measures to ensure that if you become disabled, someone will be able to manage your property and affairs on your behalf and for your benefit.

Without proper disability planning, if you become incapacitated, your family will likely be forced to institute guardianship proceedings. A guardianship is, in essence, a lawsuit by your family against you, seeking to have you declared incompetent. Guardianships typically require the hiring of two lawyers as well as getting two physicians to examine you and report to the Court. It takes time and considerable money to complete, and should be avoided at all costs.

One method of planning for disability is with a Power of Attorney. A Power of Attorney is a document that authorizes someone to act on your behalf. Anyone age 18 or over can prepare and sign a Power of Attorney appointing anyone they choose as their "agent." Powers of Attorney are perfectly legal. Unfortunately, our experience has shown us that they have limited utility, because many banks and financial institutions

refuse to recognize them (unless they are on the institution's own forms). Because the Maryland legislature has not acted to address this widespread problem, (even though many states have, by passing laws that impose fines on an institution that refuses to accept a valid Power of Attorney) there is little you can do when faced with this problem.

A much better way to plan for the management of your property in the event of your disability is to have a Revocable Living Trust. A Living Trust is a trust you establish during your lifetime, and to which you transfer much, if not all, of your property and assets. You retain full control and access over the trust during your lifetime. You name a successor Trustee who has authority over the trust in the event of your death or incapacity. The successor Trustee has access over the trust property and can make distributions from the Trust to provide for your support and welfare. This is a much more effective method of providing for your support during a period of disability.

> *The lesson: Don't overlook the fact that you may become incapacitated, and take steps necessary to enable someone to be able to act on your behalf.*

***7. Failing to avoid probate*.**

People often equate "estate planning" with writing a will. Wills are very important documents, but it is important to recognize exactly what a will is. In essence, a will is a set of instructions to the Probate Court directing how you want anything in your *probate estate* to be distributed. Your probate estate consists of any property titled in your name individually, or as a tenant in common, at the time of your death, except for any property that passes by beneficiary designation.

There are a host of procedural requirements that are necessary when an estate has to go through probate, including the appointment of a Personal Representative, filing of a bond, legal notices, the filing of an inventory of all assets, including formal appraisals, and detailed accountings, in addition to the payment of applicable probate fees. The

entire probate process is fully open to the public, so any nosy persons who want to find out what you owned at your death and who is going to get it can easily find out. The probate process is supervised by the Register of Wills.

Given the expense, delay and aggravation often associated with probate, most people would prefer to avoid it if possible. This accounts for the increased popularity of Revocable Living Trusts. Just as the Living Trust can ensure that your family will be spared the possibility of guardianship in the event of your incapacity, it can also ensure that probate is avoided when you die. This is because if your assets (including real estate, bank accounts, investments and personal property) are titled in the name of your Living Trust when you die, there is no need for probate. Your Living Trust will have the provisions you would usually expect to find in a will, i.e., what property goes to what persons. But by having the Trustee make the distributions instead of a court-appointed Personal Representative, the supervision of the probate court is avoided.

In proper circumstances, it may also be appropriate to use other means of probate avoidance, such as beneficiary designations, Payable on Death (POD) designations, jointly-titled property or "life estate deeds." However, it is very important that you understand there are often severe drawbacks to using these probate avoidance "shortcuts." Some of these are discussed elsewhere in this paper.

> *The lesson: In order to save your heirs time, money and aggravation, various methods of avoiding probate should be explored.*

8. Failing to take advantage of the use of trusts.

The most useful tools for any estate planning attorney are trusts. Trusts come in many varieties, but in essence, there is one overriding element: A trust allows you to direct how property will be used following your death.

Essentially, there are two ways you can leave property: outright or in trust. If you leave property to someone outright, they can do anything they want with the property after they get it. That means that your spouse can leave it to his or her next spouse. Or, your daughter can leave it to her husband (and not your grandchild) and he may leave it to his next wife. Or, your 21 year old can spend it on cars, jewelry for his girlfriend, beer, drugs, gambling, etc.

On the other hand, by leaving your property in a trust, you can specify in the trust how you want the trust assets to be used during the lifetime of the beneficiary, and to whom you want the remainder of the trust to pass upon his or her death. For example, it is one thing to leave your estate to your spouse and another to leave it in trust for your spouse. If you leave it outright to your spouse, then it becomes your spouse's property and your say in the matter comes to an end upon your death: your spouse can leave it to whomever he or she wants. But if you leave it in trust for your spouse, such a trust might provide that the spouse should receive as much of the income and principal from the trust as he or she needs for health, education, maintenance, and support for life, but further specify that the trust assets will be distributed to your children (or whoever you may designate) at your spouse's death.

We have already discussed why it is essential to have a trust if you have minor children. But even if your children are mature and responsible, we find that most of our clients see the benefit of structuring their estate plan to include trust provisions for children, rather than outright distributions. The main reasons for the appeal of trusts are to protect the inheritance from a failed marriage, lawsuits and creditors, and providing for the inheritance to pass to the child's children upon death. To some of our clients, the prospect of a son-in-law or daughter-in-law getting some or all of their child's inheritance, rather than that child's children, is an awful thought. Properly structured trusts can allow your children to have virtual control over the trust established for their benefit, while also protecting it from a failed marriage and ensuring that the trust will continue at the child's death for your grandchildren.

Various trusts are also essential for tax purposes. We are in a period of uncertainty over the future of the federal estate tax, therefore it is important to have flexibility built into the trust documents so that they will accommodate future changes in the law. If your will or Living Trust is more than five years old, it should definitely be reviewed to make sure it is compatible with current tax law.

> *The lesson: Trusts can provide many tax and non-tax benefits, and can be drafted to give your beneficiaries as much or as little control as you desire. It is almost always better to leave assets in trust rather than outright.*

9. Failing to keep the estate plan up-to-date.

Estate planning is a process – not an event. It is not something you do and then it is done. It must be reviewed and updated as time goes by. Tax laws change. Family circumstances change (kids get older, get married, divorced, have children, get into financial trouble, have medical issues, etc.) Your assets change. Maybe the people you designated as Personal Representative, Guardian or Trustee are no longer suitable for the job. If you haven't reviewed your will or trust and made adjustments for the changes that may have occurred in your situation, then handling your estate upon your death may be more difficult and costly for your loved ones.

If you have a Revocable Living Trust, you should periodically check to make sure that all of your assets are properly titled in the name of the Trust. Otherwise, your goal of avoiding probate may not be realized. If you've changed jobs, you should check to make sure that the beneficiary designations for your life insurance and retirement benefits are coordinated with your will or trust.

> *The lesson: Proper Estate Planning is not something you do and then forget about. Your plan should be reviewed every couple years and updated where necessary.*

10. Procrastination.

Estate planning is one of those things that we tend to put off for another day. After all, it's not pleasant to have to think about what would happen to your loved ones if you died. But, from time to time, this thought comes to mind (as we drive past a serious automobile accident on the Beltway, or as we hear about the sudden death of friends or family). These reminders will often spur us to make a momentary resolution to contact a lawyer and "finally" get a will drafted. But then weeks go by, and we don't die, and we tell ourselves that we have plenty of time to take care of it later. And the cycle repeats itself, and we never achieve the peace of mind that comes from initiating an estate plan.

I'd venture to say that almost every adult person who has died without a will, at one time intended to prepare an estate plan. They knew it was important, but it could wait until later. But they never got around to it. The result: what they would have wanted to happen after their death does not happen; some part of their estate goes to people they would rather not have it; much of their wealth goes toward taxes and probate costs that could have otherwise been avoided; their hard-earned wealth ends up being squandered by heirs who needed some structure and guidance; their heirs end up fighting one another in costly court disputes; or some other unintended consequence results. This may sound harsh, but a failure to plan is just that – ***failure***. And it is a failure that can be avoided by getting the job done.

Sure, there might be difficult decisions to be made, but any decision is better than none at all. And once you make these decisions and your plan is written, you can always change it later. The thing I hear most from my clients as they leave my office after having signed their wills and trusts is how relieved they are to have their plan in place, knowing that their wishes will be fulfilled and their loved ones protected. Often, it's a relief from the burden they have been carrying around after years of procrastination.

The lesson: If you are not sure that your estate plan is properly in place, then it probably isn't, and this causes you some anxiety. The only way to alleviate that anxiety is to get your estate plan done and keep it up to date. You will find the resulting peace of mind to be well worth the time, effort and money you invest in the process.

There is one way to avoid all of the mistakes discussed above: work with an experienced estate planning attorney and put a proper plan into place.

James A. Hyatt has been helping clients with their estate planning for over 28 years. His practice is exclusively devoted to estate planning. To inquire about a *Complimentary Initial Consultation*, visit our website at www.estateplanningmatters.com or call (301) 428-3911.

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13220 Executive Park Terrace, Germantown, MD 20874
ph: 301-428-3911 • fax: 301-428-3071
www.estateplanningmatters.com