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ESTATE PLANNING

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A. ESTATE PLANNING BASICS

What is estate planning? Estate planning is, very simply, the plan one has to pass what he or she owns to others upon his or her death. People can create their estate plans with various tools, including wills, trusts, some form of ownership of assets so the asset passes to designated persons upon the primary owner's death, and beneficiary designations in contracts such as insurance policies or retirement accounts. Others who create no such plans directly actually have an estate plan, but because of choice or inaction, their estates will pass as provided by state law.

Objectives. Estate planning can have a number of objectives. Perhaps foremost, almost every client involved in estate planning wants to make sure that the client's property passes to those the client has chosen. Most also want to eliminate or minimize the various costs involved, from estate and inheritance taxes to probate costs. There might be a desire to preserve a family business or farm. Sometimes objectives can conflict, such as a farmer who wants to leave his farm to a son (who has been participating in what is really a family farming enterprise), but who also wants to equally benefit a daughter, who is employed in town and not involved in the farming operation; often the farm makes up the bulk of a farmer's estate, so leaving the farm to the son makes it difficult to treat the daughter equally.

B. ESTATE PLANNING TOOLS

Will. Perhaps the most common estate planning tool is the will. A will is a direction as to who should receive property of the "testator" (the person signing the will) upon his or her death.

Many wills include a "laundry list," which is a provision that allows the testator to make out a list detailing who is to receive specific items of "tangible personal property," such as jewelry items, coin collections, pieces of furniture, etc. The "laundry list" cannot be used for intangibles such as cash or stocks and bonds, or for real property. The "laundry list" is ideal for family heirlooms that are to be directed to specific people, and the list is convenient because it can be made in the comfort and privacy of the home, and changed whenever something else comes to mind, without having to pay a lawyer to make additions or changes.

All wills should list those who are to receive the personal property (other than the personal property disposed of by a "laundry list"). If there are any specific transfers, such as specific items or amounts of cash to be given to specific persons or charities, these typically are listed after the personal property has been handled. A simple will would then move on to what is

called the “residue,” which is everything else owned by the decedent.

Trust. Trusts seem to be a little scary to people who have not dealt with them before. However, the concept is quite simple. A trust is an arrangement where the legal ownership of the “trust property” is held by one person or entity (the “trustee”), while the benefit of the “trust property” is reserved to the “beneficiary.” A trust should almost always be used if minor children are to inherit property, because the law does not allow minors to deal with more than a small amount of money. So parents with minor children should provide in their wills for a trustee to hold legal title to their property until the children reach at least the age of majority, which is 19 in Nebraska, or perhaps even an older age, because many feel that a 19 year old should not inherit a large amount of money. Many clients choose to have part of the trust assets transferred to the minor’s full control at one age, and the balance several years later, so the child can learn gradually how to handle financial matters.

A trust can be created in a person’s will, so that it comes into existence only if certain conditions take place (such as both parents die before all children reach an appropriate age), or trusts can be created immediately, and in that event they may eliminate the need for a probate process (discussed in another article: [insert link]).

Form of Ownership. Property may be owned in a way that controls who will own the property after one owner’s death.

> Joint Tenancy. Perhaps the most common way to accomplish this is if two or more persons own something jointly, with right of survivorship, often shortened to “JT WROS.” It is very common for spouses to own their home, cars, and/or bank accounts in joint tenancy. Sometimes parents (particularly if they are not married) will own property jointly with one or more children. In such a situation, upon the death of one of the joint owners, ownership of the property in joint tenancy passes immediately and automatically to the surviving joint tenant(s). For joint interests in real estate, it is necessary to file an affidavit with the Register of Deeds to show that one of the joint tenants has died. For accounts, title can be changed with the bank by taking a certified copy of the death certificate to the bank. The key is that no probate is required, and a will has no effect on joint tenancy property.
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> Tenancy in common. When two or more people own an asset together, but they do not want the property to pass to the other(s) when one owner dies, they should own the asset as “tenants in common.” Tenants in common each own what is called an “undivided interest” (an undivided 50% interest, if there are two tenants in common) in the property. In this situation, when one owner dies, his or her “undivided interest” in the property passes as provided by his or her will (or by law, if there is no will), and does not automatically go to the other owner(s).
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> “Pay on death” or “transfer on death.” Assets may be owned by a single person, with a “pay on death” (POD) or a “transfer on death” (TOD) designation. Joint tenancy is often used when the choice is for multiple persons (such as spouses) to own an asset together. With a POD or TOD designation, only the named person owns the property during his or her life. However, upon the owner’s death, the result is basically the same as for joint property: the asset passes instantly and automatically to the person designated in the POD or TOD option, and it is only necessary to satisfy the appropriate

party (bank, insurance company, etc.,) that the named owner has died, usually accomplished with a certified copy of the death certificate.

These are the primary ways that more than one person may own a piece of property. It is very important that a party engaged in estate planning know and understand how he or she owns his or her property because the manner of ownership may very well determine who will receive the property upon death. For example, a parent could very carefully provide in her will that her children will share her estate equally, but if she owns a substantial asset jointly with one child, that asset will go to that child, and then everything else will get divided equally among all the children, so the child that jointly owns the substantial asset will receive much more than the other children. Joint ownership is one of many estate planning tools and can be used effectively, as long as the effect of the form of ownership is understood and taken into account in the planning process.

C. PROBATE

"Probate" is the process by which property is transferred from one who has died to the appropriate new owners. If the decedent had a will, then we say that the will is probated. If the decedent had no will, then we have an intestate probate.

Probate can be broken down into five basic elements:

Estate is Opened. First, the estate must be opened, which simply means that the probate process is started and someone is appointed "personal representative" (PR). The PR is simply the person who represents the estate. We used to use the term "executor" for this person, and many still think of this name for this person. When the estate is opened, the clerk of the court will set the "claim day," which is the deadline for filing claims against the estate. Claim day is going to be approximately two months after the estate is opened. Part of the opening process requires that notice of the appointment of the PR and the claim day be mailed to all persons who have an interest in the estate (persons named in the will, close relatives, and persons known to claim that the decedent owed them money). This notice is also published to give "the world" notice of the estate proceeding, in case there are people unknown to the PR and lawyer who have an interest in the estate.

Estate is Administered. The second element of the estate requires the PR to collect and preserve the estate assets and to administer claims. For example, if there is a house, the PR is responsible to make sure that it is maintained and insured during the probate process. About three months after his or her appointment, the PR is required to file an inventory listing all of the assets of the estate. Claim day will have run by the inventory deadline, so the PR must check to see what claims have been filed. If there are claims that the PR questions, those claims must be disallowed within 60 days of the claim deadline. If a claim is disallowed, the claimant must bring an action to have the claim validated, or the claim is no longer an issue. All claims not disallowed are automatically allowed, and they must then be paid, if there are sufficient assets.

Inheritance Tax. The third element of the estate requires the PR to have inheritance taxes determined. Often, the inventory is filed before all asset information is known. For example, the estate may be selling the decedent's house or other property, and in

the inventory, the property is listed at the value at which it is hoped to sell. If the property actually sells, it is often at a slightly different price. If there is new or changed inventory information, then the PR may file an amended inventory with more accurate valuation numbers. The inheritance tax worksheet begins with the correct valuation numbers. We then take all available deductions and allowances. Nearly everything that the PR pays out of the estate checking account will be a deduction against the inheritance tax, either as an administrative expense or as a debt of the decedent (such as claims that are paid).

The inheritance tax owed depends on the relationship between the person who has inherited the property and the decedent. The spouse of the decedent never owes any inheritance tax. A descendant (child, grandchild, etc.) or a sibling receives the first $40,000 tax free, and then is taxed 1% on all amounts above $10,000. "Remote relatives" are pretty much any other relative (e.g. a cousin, nephew or niece, or descendants of such relatives) and they receive the first $15,000 tax free, and are then taxed 13% on amounts above that. Unrelated persons are socked with the most inheritance tax; they receive only the first $10,000 tax free, and then the tax is 18%. The bottom line is that inheritance tax does not affect a surviving spouse, it is of little concern to a descendant, but it can be a major expense for more distant relatives and particularly for unrelated persons. (Note that a couple that has lived together for years as spouses, but who never married, are legally unrelated and will have to pay inheritance tax at the highest rate.)

Distribution of Assets. Once claims have been administered and inheritance tax paid, then the PR moves to the fourth part of the probate, which is to distribute the assets to the appropriate persons. Real estate is deeded to the proper heirs, personal property is delivered, ownership of stocks is transferred, and cash is distributed. It is important to secure receipts from the distributees.

Estate is Closed. The fifth and final part of the probate process is to close the estate.

Formal or informal. The opening and closing of estates may be done either formally or informally. Formal probate is normally used only when a dispute is expected, or something unusual is taking place. A formal proceeding happens only after notice is mailed to all parties, published, and then there is a hearing in front of the county judge. If no disputes are anticipated, the process can be done by the PR signing papers in front of a notary, and then those papers are simply filed. If an estate is closed informally, it is not really closed until one year has passed; this time allows all interested parties time to find out what has happened and to file an appropriate pleading to raise any issues that the person filing the pleading believes remain to be resolved. If that happens, the informal probate turns into a formal one.

D. ESTATE TAXES

In recent years, Congress has raised the threshold above which federal estate taxes kick in, making federal estate tax a nonissue for all but the largest estates. Currently, there is no federal estate tax until an estate reaches three and a half million dollars. Keep in mind that the value of the estate for estate tax purposes includes all property owned by the decedent, as well as most insurance on his or her life, as well as retirement accounts. There is no longer any Nebraska Estate Tax–just the inheritance tax discussed above.

Credit shelter trust. The federal estate tax credit is currently $3,500,000. A very simple tool can make sure that a couple can pass double the credit amount to their children totally free of estate tax–$7,000,000. Many couples have the simple estate plan where the estate of the first to die is left to the survivor, and then when the survivor dies, the combined estates of the husband and wife pass to the children. If the total estates of the husband and wife are more than the single credit ($3,500,000), then the couple is going to pay unnecessary estate taxes. Because there is no tax between spouses, when the first spouse dies and leaves everything to the survivor, the estate tax credit available to the first spouse to die is wasted! There is a very easy and complete solution to this problem. First, the couple needs to make sure that each spouse owns approximately half of the couple's combined assets in his and her name alone. If the house is owned as joint tenants, it can be changed to tenants in common. If stock accounts are owned jointly, they should be divided up and roughly half owned by each spouse. Then each spouse should sign a will that includes what is called a "credit shelter trust." This name is used because the trust "shelters" and protects the estate tax credit. All or an appropriate part of each spouse's estate is left in this shelter trust; the assets are available to the surviving spouse for as long as he or she lives, to maintain that surviving spouse in the standard of living to which he or she is accustomed. Then, when the surviving spouse dies, the property in the credit shelter trust passes to the children. In this way, both spouses can fully use their credit to pass the maximum the law allows estate tax free to the next generation.