

FIVE ESTATE MISTAKES

Understanding key concepts can help you save you from a bad estate plan

Every reader of this article has an estate plan, whether or not they know it. Some have taken a proactive approach and retained counsel to create a plan and draft appropriate documents that express their wishes. The rest – perhaps unknowingly – rely on the laws of the state in which they reside. The laws affecting people like you have become increasingly complex, and it is up to the client to seek appropriate advice at an early date.

Power of Attorney

Some may be tempted to download a power of attorney form from the Internet. Anyone can search the Internet for the term “power of attorney” and find Web sites with standardized forms for sale or immediate download. This might sound like a simple solution, but don’t be misled.

The basic power of attorney documents found on the Internet often do not cover the very specific issues you may need addressed. Many are never signed or drafted properly and thereby useless when it comes time to use it and then it can be too late. Medical powers of attorney are not always included, nor are clauses about gifting, real estate transactions or the ability to make asset transfers to affect Medicaid eligibility. These are important parts of your estate plan that require case-by-case consideration.

Tax Allocation Clause

One of the most important provisions in a Will is the tax allocation clause, which allocates a decedent’s estate or inheritance tax burden among the estate beneficiaries by specifying the source or fund from which the death taxes are to be paid. The allocation of taxes among beneficiaries of an estate is generally governed by the terms of a testator’s Will, a nontestamentary instrument passing nonprobate property or the default rules under applicable state law.

Despite the importance of tax allocation clauses, which can dramatically alter the dispositive provisions of a client’s estate plan, many practitioners rely on general boilerplate tax clause provisions for all clients without fully examining the impact that such clauses have on the plan. Generally, a tax clause contained in a Will charges the estate’s tax burden to the residuary estate or apportions the tax burden among the estate beneficiaries in proportion to their share of the estate tax liability. Often, a boilerplate

tax allocation clause commonly found in Wills charges the testator's residuary estate under the Will with the burden of all taxes imposed on both probate and nonprobate property. An example where a tax allocation clause resulted in a presumably unintended result involved the estate of Charles Kuralt. His 1994 Will provided that all estate, inheritance and other death taxes imposed by reason of death would be paid, without apportionment, by his residuary estate. The residuary beneficiaries included his surviving spouse and two children. Shortly before his death, he prepared a handwritten codicil (which was ultimately admitted to probate) that devised his Montana ranch to his longtime companion. Since the terms of Kuralt's Will provided that the taxes were to be paid from the residuary estate, the residuary beneficiaries (his wife and kids) bore responsibility for payment of taxes attributable to the property that passed to the companion.

Special Needs Trust

Consider establishing a special needs trust if one of your potential beneficiaries is entitled to government benefits such as Supplemental Security Income or Medicaid. Direct receipt of funds will cause the individual to be disqualified, which means the funds will need to be spent down before requalifying for the benefits. This result is particularly harmful for those who incur substantial medical expenses each month.

Consider a situation in which Mom and Dad have three children, one of whom is disabled. The parents die together in an accident and neglected to do their Wills. In most states, the children will be entitled to receive the inheritance in equal shares. Since the disabled child's share is not diverted to a special needs trust, the result will be disqualification from the entitlement program that he or she may have been otherwise eligible until the funds are spent.

Another situation can arise where a client is in a nursing home, the costs of which are being covered by Medicaid. A family member dies, leaving the person in the nursing home an inheritance. Again, the person in the nursing home is disqualified from Medicaid. This means that he or she must pay the nursing home bill directly (at a rate of \$5,000 to \$9,000 per month, depending on the locale) until only \$2,000 remains.

State Estate Tax

Since the state death tax credit was repealed at the federal level through the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), many states have imposed their own estate tax. (It is important to know that an estate tax differs from an inheritance tax. Some states have both, and some states have neither). New Jersey has both.

The planning focus is often on the federal estate tax, and many erroneously believe that tax planning is no longer necessary in light of the current federal estate tax exemption of \$3.5 million as of January 1, 2009. The state estate tax can be avoided in many cases; therefore, you need to take a proactive approach with respect to this issue. In New Jersey, the exemption is \$675,000.

Updated Documents

When important changes occur in our lives, we need to revisit our Wills and beneficiary designations to make sure that our current intent is expressed. The following are major events that might motivate individuals to take a second look at their Will:

- Marriage or new life partner
- Divorce
- Birth of a Child
- Change of who will inherit your assets
- Change of who should handle your estate after your death
- Death of a loved one

Many have failed to update their documents since the enactment of EGTRRA in 2001. This mistake has caused many surviving spouses to unnecessarily incur New Jersey state estate tax liability at the death of the first spouse.

Don't allow your estates to suffer unintended consequences. Become more familiar with the laws affecting you by seeking the advice of an attorney with expertise in this complex area of law.