TOP TEN ESTATE PLANNING MISTAKES

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WHAT IS ESTATE PLANNING?

- Estate planning is no longer just about avoiding estate taxes and what happens with your assets at death
- Other driving factors include…

INCAPACITY PLANNING

ASSET PROTECTION

INCOME TAX PLANNING

FAMILY HARMONY

LEGACY PLANNING

ESTATE, GIFT & GST TAX FIGURES (2021)

- Annual gift tax exclusion = $15K per donee per year
- Unlimited gift/GST tax exclusion for funds for medical or educational expenses paid directly to institution
- Federal estate, gift and generation-skipping transfer (GST) tax exemption =$10MM (indexed annually for inflation), with portability
- No separate VA estate (or gift) tax
- Separate MD estate tax – currently $5MM, with portability
  - Additional MD inheritance tax for collateral and unrelated heirs/beneficiaries
- Separate DC estate tax – currently $4MM, without portability

1. DOING NOTHING, OR DOING IT YOURSELF

- Doing nothing often leads to "crisis planning" forcing loved ones to resolve matters during an already emotional and difficult time

- It's not "all boilerplate" – DIY'ing it inevitably leads to mistakes and/or omissions that cannot be corrected once an individual becomes incapacitated or deceased
  - Can lead to unnecessary legal fees, taxes and/or litigation, defeat your intentions and prevent orderly distribution and management of your assets

- Failing to periodically update documents to take into account tax and non-tax law changes and upon certain other life events (e.g., moving to another state, getting married/divorced etc.) can also create unnecessary complications

2. FAILING TO PROPERLY FUND REVOCABLE TRUST

- Primary benefits of a revocable trust (avoiding court-supervised probate or guardianship proceeding upon death or disability, and preservation of privacy) will generally be lost if assets are not properly retitled into the trust
- Joint spousal property is generally divided between and transferred to each spouse's separate revocable trust (or to Joint Revocable Trust)
- Failing to convey out-of-state real estate to revocable trust can result in ancillary probate proceeding in that state
- Don't forget about retitling closely-held business interests into revocable trust (or making TOD to the trust)
- If retirement account is made payable to revocable trust (e.g., as contingent beneficiary FBO minor children), make sure trust contains requisite provisions to allow trust to qualify as designated beneficiary under RMD rules (see Mistake #8)

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3. USING A POORLY DRAFTED JOINT TRUST

- Joint Revocable Trusts (JRTs) have become more prevalent given the higher Federal estate tax exemption and availability of the portability election
- Beware of poorly designed JRTs that attempt to maintain separate shares for separate vs. joint property, which typically require tracing of spousal contributions at the first spouse's death (or upon divorce)
  - Can lead to a host of marital and/or tax issues during the spouses' joint lifetime and after the first spouse's death in non-community property states
  - Can be difficult to determine what portion of the trust assets are includible in the estate of the first spouse to die (Deceased Spouse) for income tax purposes

3. USING A POORLY DRAFTED JOINT TRUST (CONTINUED)

- Properly designed JRT mimics spousal joint ownership in that each spouse is deemed to own an undivided one-half of the trust assets as tenants in common
  - Tenancy by entirety character of TBE property contributed to the JRT is generally retained
  - Each spouse retains the unilateral right to revoke their one-half share of the trust
  - Deceased spouse's share of JRT becomes irrevocable upon his or her death, and passes to surviving spouse's share (with ability to disclaim into Family Trust) or retained in Marital Trust
  - Surviving spouse's share of JRT remains revocable and amendable during his or her lifetime
- Generally, JRTS are not recommended for couples with significant amounts of separate property that they wish to keep separate, or for couples with children from a prior marriage

4. LEAVING ASSETS OUTRIGHT, OR REQUIRING MANDATORY TRUST DISTRIBUTIONS, TO CHILDREN

- Mandatory outright distributions to beneficiary (either lump sum or gradual upon attaining certain ages) destroys asset and spendthrift protections otherwise available for inheritance left to a discretionary trust
  - Assets left outright can also be potentially diverted to child's future ex-spouse, creditors and other "unintended beneficiaries"

- Outright distributions to a disabled beneficiary can also render the beneficiary ineligible for Medicaid and public benefits

- Important to include flexibility and guidance to the trustee in the trust document
  - Beneficiary can become their own trustee (or co-trustee) upon attaining a specified age, with the ability to make distributions to themselves for health, education, maintenance and support
  - Independent Trustee can be given additional discretion to make significant distributions of principal upon milestones (e.g., marriage, purchase of home, attaining specified age, etc.) based on beneficiary's current situation and solvency
  - Trust terms should specify whether outside resources of the beneficiary should be considered, and whether interest of current/primary beneficiary are to be favored over interests of the remainder beneficiaries
  - Grantor can provide side letter to trustee to provide additional guidance

- Consider appointing corporate trustee (or co-trustee), when appropriate

5. IMPROPER SELECTION OF TRUSTEE, & FAILING TO NAME A TRUST PROTECTOR

- Various fiduciary duties of a trustee, including:
  - Manage/preserve trust assets in accordance with trust document and applicable state law(s)
  - Duty of impartiality/good faith
  - Recordkeeping and tax reporting/elections
  - Providing information and reports to beneficiaries as required by trust document and state law and/or Uniform Trust Code (UTC), if applicable
- Surviving Spouse may not always be the best or most qualified person to name as trustee, particularly in 2nd+ marriage situations with children from prior marriage

5. IMPROPER SELECTION OF TRUSTEE, & FAILING TO NAME…(CONTINUED)

- Naming an individual (e.g., spouse, relative, or friend) as sole trustee, even if the individual is qualified/skilled in the duties of a fiduciary, is time-consuming and leaves individual open to potential conflicts with unhappy beneficiaries

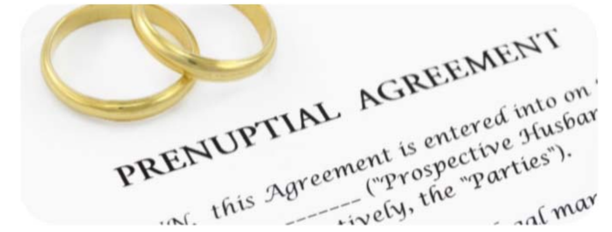
- Naming multiple individuals (e.g., children) as co-trustees can create unnecessary administrative burdens and potential conflicts in trustee decision-making

- Naming individual (or beneficiary upon attaining certain age) and professional/institution as co-trustees allows family member or other trusted individual to provide input on distributions and can leave other administrative tasks to professional trustee

- Important to appoint Trust Protector to remove and replace trustee (with or without cause)

6. FAILING TO USE PRE-NUP AND/OR MARITAL TRUST

- Use of Marital Agreements (pre-nuptial and post-nuptial) can prevent intra-family disputes during life and at death



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- Marital Trust requires that all trust income be distributed to surviving spouse as the sole beneficiary during his or her lifetime, and directs remaining trust assets to intended beneficiaries (e.g., children from prior marriage) at surviving spouse's death
  - Marital Trust designed as a "unitrust" (defining trust income as 3-5% of the trust's annual fair market value) is often easier to administer and allows trustee to invest based on "total return" approach

- Life insurance can also be used to provide a guaranteed legacy/distribution to children at deceased spouse's death (rather than waiting to receive remaining assets in Marital Trust at the surviving spouse's death)

7. PUTTING CHILDREN'S NAME ON BANK ACCOUNTS AND OTHER ASSETS

- Often done as substitute for a durable power of attorney and/or as probate work-around
- Exposes asset to child's creditors (including future ex-spouse upon divorce)
- May result in unintended and/or unequal distributions of assets/estate among children/intended beneficiaries
- May create unintended gift tax consequences
  - Adding child as a joint owner on real estate (for no or inadequate consideration) generally results in completed gift of undivided/allocable interest in the property
  - Adding child as a joint owner on bank/investment account generally results in completed gift when child makes withdrawal from account not attributable to his or her contribution (if any)
- Depending on whether asset is owned as joint tenants with right of survivorship or tenants in common, all or a portion of the property will remain includible in the parent's estate

8. FAILING TO PROPERLY NAME & UPDATE BENEFICIARIES

- If a trust is named as the beneficiary of a retirement plan, care must be taken to ensure the trust qualifies as a "designated beneficiary" under the RMD rules
- Regardless of changes to RMD rules under the SECURE Act, same rules still apply if there is no "designated beneficiary" (e.g., payable to estate, charity, or to trust that does not qualify as a DB)
  - 5-year rule if participant dies before required beginning date (RBD), or
  - Life expectancy of the participant if he/she dies after RBD ("ghost" life expectancy)
- Life insurance ownership and beneficiary designations should be reviewed to confirm they accurately reflect the estate planning goals, particularly upon divorce, birth of child, etc.
- If no beneficiary is named, retirement plan or insurance proceeds are generally payable to decedent's estate, which will require probate

9. FAILING TO FULLY UTILIZE ESTATE, GIFT OR GST EXEMPTION, OR ANNUAL GIFT TAX EXCLUSION

- Implement annual exclusion gifting program, via outright gifts or gifts in trust, to reduce and transfer future appreciation out of taxable estate
- "Use it or lose it" time window for clients who have already used the pre-2017 Tax Act exemption ($5.49MM in 2017) to utilize excess exemption via lifetime gifts to an irrevocable trust for spouse and/or children/descendants (via SLAT/Dynasty Trust)
- "Dynasty Trust" planning can maximize/leverage GST exemption and transfer wealth to future generations, free of transfer tax
  - Designing trust as a grantor trust for income tax purposes allows grantor to make additional tax-free gifts by paying income tax attributable to the trust

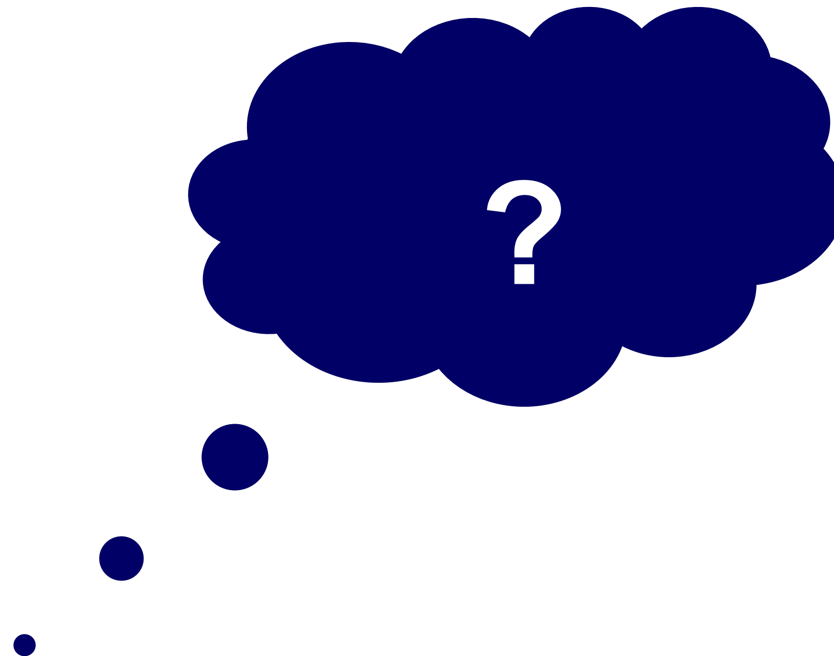
9. FAILING TO FULLY UTILIZE ESTATE, GIFT OR GST EXEMPTION… (CONTINUED)

- Consider gifting closely-held business interests and assets with depressed valuations or that are likely to highly appreciate to leverage estate/gift/GST exemption and shift future appreciation out of donor's estate
  - Be mindful that donee will generally take carryover basis in gifted property
  - Special provisions can be included in trust agreement authorizing independent trustee to grant a testamentary general power of appointment to beneficiary to make trust assets includible in beneficiary's estate and eligible for stepped-up basis
  - Grantor can also exercise "swap" power to substitute assets of higher basis for low basis assets if trust is designed as a grantor trust

10. FAILING TO WORK WITH A TEAM OF ADVISORS

- Working with a team of advisors provides continuity and management of information for family members and trusted individuals, particularly in times of crisis
- Allows aging clients and their families to have a coordinated plan to avoid crisis situations
- Allows each advisor to stay in their "lane" of expertise and bring in additional resources when needed
- Potential cognitive decline and other warning signs can be more easily detected among the client's advisory team
- Annual meetings with the advisory team can uncover changes in the client's situation and provide coordinated implementation of necessary updates to the client's financial, estate and/or care plan

QUESTIONS?



THANK YOU!

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Melinda focuses on providing holistic multi-generational income and wealth transfer tax planning advice and estate and trust services to high net worth individuals, families, and business owners.

She brings a unique and diverse perspective from her work in private law practice, Big Four accounting firms, and private banking/trust services.

Melinda is listed among the *Washingtonian* and *Northern Virginia Magazine's* Top Trusts and Estates/Tax Lawyers, and is a frequent speaker and writer on estate and trust planning. She recently attained the Accredited Estate Planner® (AEP®) designation by the National Association of Estate Planners & Councils.

On a personal level, Melinda is a strong supporter of local philanthropy and the arts in Northern Virginia, and is a current Board member of the Community Foundation for Northern Virginia.