THE PENNSYLVANIA BAR ASSOCIATION

Quarterly

COMMON ESTATE PLANNING BLUNDERS—HOW TO CORRECT AND AVOID THEM

Written and produced by Edward L. Perkins

CPAs - 1.0 hour Interactive Self-Study
ATTORNEYS (PA CLE) - 1.0 hour Online CLE
FIELD OF STUDY - Estate Planning
PROGRAM LEVEL - Basic
PREREQUISITE - None
ADVANCE PREPARATION REQUIRED - None

PENNSYLVANIA BAR ASSOCIATION

Your Other Partner

October 2010 • VOLUME LXXXI, NO. 4

Course Booklet

YourOnlineProfessor.NET

Common Estate Planning Blunders—How To Correct And Avoid Them

By EDWARD L. PERKINS, JD, LLM (TAX),* Delaware County
Member of the Pennsylvania Bar

TABLE OF CONTENTS

---

* Mr. Perkins has a J.D. degree from Villanova University School of Law and an LL.M. degree from Temple University School of Law. He is a principal shareholder in the law firm of Gibson&Perkins, PC, Media, Pennsylvania. He is also a faculty member in the Graduate Tax Program at the Villanova Law School. In that program, he most recently taught "The Drafting Fundamentals of Estate Planning Documents"—a course that he developed for the program. In the past, he has taught "Comparative Taxation of Business Entities", "Federal Estate and Gift Tax", "Estate Planning", "Tax Research", "Taxation of Individual Taxpayers", "Taxation of Corporations and Partnerships", "Advanced Tax Accounting", and "State and Local Taxation." Mr. Perkins is a frequent speaker for the Pennsylvania Bar Institute and other professional groups, and the founder of YourOnline_Professor.net—an on-line continuing education provider for Attorneys and CPAs.

As an estate planner for over thirty five years and in my course "The Drafting Fundamentals of Estate Planning Documents" which I taught for many years in the Graduate Tax Program of the Villanova Law School—I have had occasion to observe a multitude of estate planning missteps and miscues. Here's my list of what I consider the "Thirty of the Most Common Estate Planning Blunders", and how to avoid them.

FAILURE TO OBTAIN COMPLETE INFORMATION BEFORE COMMENCING THE ESTATE PLANNING PROCESS

Good estate planning must begin with complete information. Before beginning the estate planning process, you must first obtain both complete financial and complete family information; as well as copies of existing estate planning documents.

This Article will highlight some of the most common blunders made in the estate planning process and how to avoid them. A must read for both the novice and experienced estate planner and everyone in between.

You must, of course, have a complete picture of the client's financial profile. There are several objectives in obtaining this information: first, to identify the assets of the estate; secondly, to estimate the relative value of those assets; and finally, to determine the manner in which the property is titled. This last point is particularly important in the case of a married couple. Whether the property is held in one spouse's name alone or whether it is titled in joint names will play an important role in the estate planning process.

A request for family information should also be designed to identify the natural heirs of the client. It is therefore important that the client provide the identity and age of each of the members of his or her immediate family. The client should also provide the identity of any potential non-family heirs, such as friends and charitable institutions.

In addition, you should request disclosure of information which may affect the disposition of the client's estate—such as copies of pre- or post-nuptial agreements, or property settlement agreements made pursuant to a divorce.

Finally, copies of the client's current estate planning documents including Wills, trusts, and powers of attorney should also be requested. These documents will provide you with a look at the existing estate plan and also may prove a useful starting point in determining what changes should be made.

GETTING THE NAMES WRONG

The most obvious error and the quickest way to lose the client's confidence is to misspell or mis-reference the names of the client or his or her family members in the documents. Always make sure that the names in the documents—even in draft form—are correctly stated before they are released to the client.

FAILURE TO ADEQUATELY PROVIDE FOR THE DISPOSITION OF PERSONAL EFFECTS

It is important that the Will specifically address the disposition of the client's "personal effects." The term "personal effects" includes items such as watches, rings, collections, etc. Even though this type of property may not have great economic value—due to its sentimental value the manner in which this type of property is disposed of in the estate plan may have the potential to create conflict and bad feelings among the heirs. Therefore, the Will should provide for a specific distribution of personal effects or a predetermined method of dividing the property in a way that avoids potential problems.

Look out for a provision like the following:

"My personal effects to my children in substantially equal shares as they shall agree."

Equally problematic could be a provision like this one:

"My personal effects to my children in substantially equal shares as my Executor may decide."

This type of language is a poor way to avoid future conflicts if one of the heirs is also serving as executor. One possible solution is that the Will provide that personal effect property be disposed of in a memorandum created by the client outside the Will. The language in the Will addressing the memorandum might take the following form:

"I give all household goods and personal effects owned by me at my death and all insurance policies on such property to those individuals who survive me by thirty days who are designated on a memorandum, list or letter signed by me which refers to this Will or is found with a copy thereof, the items listed beside their names. A gift to any such individual made pursuant to such memorandum, list or letter to an individual who does not survive me shall lapse and such property be disposed of under subparagraph b., below."

A memorandum provision allows the testator to delineate the disposition of specific items of personal property to specific heirs without having to provide for a disposition in the Will. An added advantage of a memorandum provision is that it can be changed by the client without involving the attorney.

Another alternative might be a "lottery provision," which allows each heir to choose an item of personal property in turn, until the property is totally divided. In any case, a provision dealing specifically with personal effects goes a long way to avoid family conflict.

FAILURE TO ADEQUATELY IDENTIFY THE GIFTED PROPERTY

Make sure the document describes the gifted property so that the executor can easily identify the property which is the subject of the gift. If there is an external reference, such as an account number or license number (e.g., in the case of bank accounts, automobiles, boats, etc.) then use it. For gifts of real estate describe the property as you would in an agreement of sale, that is use the legal description, or a "commonly known as" reference such as the street address. In regard to collections and other property groups the gift provision should clearly define the gift so that the executor can determine which items are considered a part of the group and which items are excluded. In some cases it is also recommended that the testator create an external list, catalog, or other reference outside the Will in order to make the identification of the collection or property group even more definite. Also, you might consider adding a "savings clause" like the following, in order to protect the executor:

"If there is any dispute as to the items which are considered part of such collection, my Executor to make the final determination in his sole discretion."

INADEQUATE IDENTIFICATION OF THE HEIR

As in the case of property descriptions, the Will should identify the heirs in such a way so that the executor can easily identify the individuals or entities to which gifts are made. It is good practice therefore to delineate the heir, by name and relationship to the testator. If there is any possibility for confusion consider adding the residence address, or additional descriptive terms. For example:

"My gold watch to my cousin, WILLIAM SMITH."

or

"My gold watch to my friend, ROBERT SMITH, who at the time of the execution of this Will is residing in Reading, Pennsylvania."

In the case of gifts to a class, remember to draft the class definition so that the date on which the class is to be determined is specified if it is other than the date of death, and anyone excluded from the class is specifically identified. Also keep in mind that if the class definition could be interpreted to include a person who is otherwise expressly excluded from general benefit under the Will, he or she will be held to be a member of the class unless other language clearly expresses a contrary intent.

Consider this language so as the following:

". . . to my children, <u>living on my date of death</u>, including children born or adopted after the execution of this Will, but specifically excluding my son, JOSEPH."

FAILURE TO ANTICIPATE APPLICATION OF THE ANTI-LAPSE PROVISIONS OF THE PEF CODE

As a general rule if a named beneficiary under a Will predeceases the testator the gift will lapse. However, in Pennsylvania the "Anti-lapse" provisions provided in PEF Code 2514(9) create a "gift over" to the deceased beneficiary's descendants, per stirpes, if the beneficiary and the testator were related in a specified way. Specifically Sec. 2514(9) of the PEF Code provides that:

"(1) A devise or bequest to a child or other issue of the testator, or

(2) To his or her brother or sister, or

(3) To a child of his or her brother or sister, whether designated by name or as one of a class,

(4) Shall not lapse when the named beneficiary fails to survive the testator but leaves issue surviving the testator,

(5) But shall pass to such surviving issue, who shall take per stirpes the share which the deceased ancestor would have taken had he or she survived the testator,

(6) Provided that such a devise or bequest to such a brother or sister or child of a brother or sister shall lapse to the extent that it would pass to testator's spouse or issue as part of the residuary estate or under intestate law."

Therefore a gift stated like this for example—***"I give $1,000 to Thomas Smith"***, will have different connotations in the event that Thomas Smith predeceases the testator depending upon his relationship to the testator. If Thomas Smith is merely a friend the gift will lapse. On the other hand, if Thomas Smith is a child of the testator, or a brother of the testator, the gift will not lapse but will instead pass to his surviving issue, per stirpes. Get used to asking the question:

"If [so and so] dies, is it your intention, that this gift should lapse, or would you like it to pass to [his or her] children, or grandchildren?"

. . . and draft consistent with the testator's intent.

The application of the Anti-lapse provisions can be overridden by an expression of contrary intent. If the client intends the gift to lapse, make the gift contingent upon survival, but also provide that in the event the survival contingency is not met the gift shall lapse. For example:

"I give $1,000 to Thomas Smith, if he survives me, <u>otherwise this gift shall lapse.</u>"

If the client wishes instead that there should be a gift over, then language like the following might be appropriate:

"I give $1,000 to Thomas Smith, if he survives me, <u>otherwise to his then living issue, per stirpes</u>."

In any case the Anti-lapse provisions should never come into play in regard to a well drafted gift provision.

TAX ALLOCATION PROVISION WHICH PRODUCES UNANTICIPATED RESULT

A typical tax allocation provision in a Will often provides that all death taxes on probate assets shall be paid out of the residuary estate.[1] Sometimes the tax provision in the Will also allocates the taxes generated by non-probate assets such as IRA accounts to the residue.[2] This means that the residuary estate will be reduced by the death taxes generated by the entire probate and non-probate estate, and that other gifts will pass unreduced by death taxes. This might not be consistent with the intent of the client. A prudent estate planner should always review the effect of the tax provision in the Will to determine specifically how it impacts the various dispositions made both under the Will and outside the Will. This is particularly important when dispositions are made to different heirs.

INADEQUATE ADMINISTRATIVE PROVISIONS

The administrative provisions provided in a Will should at a minimum be designed to allow the executor the ability to perform administrative functions without having first obtained court approval. Here are some of the administrative provisions the Will should contain: (i) the power to apportion receipts between income and prin-

---

1. For example: "*(a) All death taxes (and interest and penalties thereon) imposed as a result of my death upon property passing under my Will, shall be paid out of the principal of my residuary estate, each share thereof, whether outright or in trust, to bear a pro rata portion of such taxes.*"

2. "*(a) All death taxes (and interest and penalties thereon) imposed as a result of my death upon property <u>regardless of whether passing under my Will</u>, shall be paid out of the principal of my residuary estate, each share thereof, whether outright or in trust, to bear a pro rata portion of such taxes.*"

cipal[3]; (ii) the power to borrow[4]; (iii) the power to carry on business[5]; (iv) the power to compromise claims[6]; (v) the power to distribute assets in kind[7]; (vi) the power to expend or apply funds[8]; and (vii) the power to purchase all forms of property.[9]

In addition consider including some or all of the following provisions in order to further facilitate the administration process: (i) the power to retain real and personal property in the form in which it was received; (ii) the power to sell, lease or give options upon any real or personal property; (iii) the power to exercise any option or join in any recapitalization, merger, etc. affecting any investment; (iv) the power to hold property unregistered or in the name of a nominee; (v) the power to exercise all rights of real estate ownership; (vi) the power to buy real and personal property from the estate and to lend money to the estate; (vii) the power to join in making gifts with decedent's spouse; (viii) the power to apply expenses permitted as income and estate tax deductions; (ix) the power to terminate a small trust; (x) the power to pool assets of separate trusts; (xi) the power to merge trusts if trusts are primarily for the benefit of the same persons and are similar in terms; and (xii) the power to employ accountants, brokers, etc. to provide services to the estate/trust.

FAILURE TO PLAN FOR MINOR BENEFICIARIES

The estate plan should include planning designed to care for both the person and the property of minor beneficiaries. Under PEF Code §2519, the sole surviving parent is generally entitled to appoint a guardian, who will act in *loco parentis* with respect to his or her minor children. However, the guardian of the person does not control a minor's property.[10]

In Pennsylvania a child under age 18 cannot inherit property valued in excess of $25,000, without a formal guardian of the property being appointed by the court.[11] There are several alternatives to having the court appoint a guardian of the minor's property.

First, the testator may appoint a guardian of the minor's property left to them under the testator's Will. There are a number of reasons why a guardianship is not

---

3. In the absence of a testamentary provision, the statutory rules contained in the Principal and Income Act, PEF Code §8101, *et seq*., will apply.

4. Absent a provision in the Will, the fiduciary must obtain court approval to borrow money when necessary to carry out their fiduciary duties (such as the payment of taxes).

5. Without express authorization, the fiduciary must obtain court approval to continue the decedent's business.

6. This power allows the fiduciary to settle claims without court approval. In the absence of such provision, court approval must be obtained.

7. In order to make a distribution in kind rather than cash, an executor must show cause. Providing the fiduciary with this power by Will obviates this need.

8. This provision gives the fiduciary the power to pay bills on behalf of a beneficiary, rather than distribute the funds directly to a beneficiary who may not be able to use the funds. The use of this power is generally premised on the beneficiary's incapacity.

9. Under Pennsylvania law, by default an executor is limited by statute to the following types of investment:

(1) Certain interest-bearing accounts;
(2) Savings accounts insured by FDIC; and
(3) Money market mutual fund affiliated with a corporate personal representative.

Authorizing the Executor to make investments in addition to those authorized by statute will overcome this limitation.

10. *See Daniels* v. *Metropolitan Co*., 135 Pa. Super. 450, 5 A.2d 608 (1939).

11. Note: The guardian of the property may or may not be the same person who is appointed guardian of the person—they are two separate jobs with two separate different sets of responsibility—one appointed to take care of the minor's person and one to take care of the minor's property.

recommended however. First, a sole surviving parent cannot be appointed the sole guardian. In addition, an expenditure of the funds requires court approval, and finally a guardianship ends at age 18.

Alternatively, the testator can appoint a custodian over property left to a minor as provided under the Uniform Transfers to Minors Act. Generally a custodian under the UTMA will enjoy greater freedom of action than a guardian. Additionally, the custodianship terminates at age 21, allowing for an additional time period during which the property may be administered on behalf of the minor.

A third alternative is a trust established for the benefit of the minor. A trust offers several advantages over both a guardianship and a custodianship. First, the trust may be designed specifically to meet the needs of the individuals involved both in terms of how the funds are expended and how they are invested during the trust term. Secondly, the trust can continue until whatever age the testator feels appropriate even far into adulthood.

LACK OF PROPER EXECUTION

It is the duty of the draftsman to ensure that the Will is properly executed, so that it may be granted legal recognition upon the testator's death. The draftsman should be physically present during the execution process. The PEF Code only requires that the Will "shall be in writing and shall be signed by the testator at the end thereof."[12] Except where it is signed by mark, no witnesses are required.[13]

LACK OF WITNESSES

If witnesses are not present at the signing of the Will, two witnesses familiar with the testator's signature can affirm the signature at probate.

LACK OF NOTARIZATION

After August 23, 1976, the PEF Code permits the execution of a Will by the testator and the witnesses in the presence of a notary public so that at death the Will may be probated without the witnesses having to appear.[14] If no notary is present in Pennsylvania, a document can be notarized after execution based on the affidavit of an attorney actually present at the signing.[15] In such a case the affirming attorney cannot also act as a witness.

APPOINTING THE WRONG EXECUTOR

If the executor is an individual, then he or she must be at least 18 years old. In order to qualify a corporation must have fiduciary power in the state of Pennsylvania. There is no requirement that the executor actually be a resident of the state of Pennsylvania, but in order to serve a non-resident executor must post a bond with the Orphan's Court unless the Will provides for a waiver of the bond.

It is important that in addition to the originally appointed executor that there be one of more successors appointed. Most married people first appoint their spouse as the executor of their Will, then one or more of their children as the successor.

If children are appointed as the first choice or as successors in something other than in the order of age—oldest first, then you should advise the testator to provide

12. PEF Code §2502.
13. PEF Code §2502(2).
14. PEF Code §2502(2).
15. PEF Code §3132.1(3).

an explanation to the older children why this decision was made. Remember the Will can be the last document that speaks from the parent to the children. Even adult children are sensitive to this type of deviation from what might be otherwise be perceived by them as the proper order of things. Often a letter left with the Will or a provision within the Will itself will go far to soften the blow for a child feeling slighted.

Generally it is a good idea to appoint individuals over banks and trust companies. Why? Not because institutional executors charge fees—they as a rule provide a valuable service in administrating the estate, have the expertise and will earn the fees they are paid. The reason is simply if the institution is not doing its job—absent negligence—it is difficult to remove them without court intervention. On the other hand an individual executor can hire the institution to perform the same administrative services it performs as executor, but if the institution does not perform as expected the individual executor can dismiss the institution at any time without difficulty.

APPOINTING THE WRONG TRUSTEE

Choosing a trustee is an individual choice based on the facts and circumstances of each case. Obviously whomever is chosen should be a responsible individual or institution which is sensitive to the needs of the beneficiaries but willing to adhere to the purposes for which the trust was created. It is also important that the document appointment a successor trustee, and that the document provide an internal mechanism for the appointment of a trustee if there is an unfilled vacancy.

If the wrong trustee is chosen, the settler, a co-trustee or a beneficiary may request that the Orphan's Court remove the trustee or the trustee may be removed by the court on its own initiative. The Orphan's Court may also remove a trustee if it finds that removal of the trustee best serves the interests of the beneficiaries of the trust and is not inconsistent with a material purpose of the trust, and a suitable co-trustee or successor trustee is available. In addition the court must believe that either: (i) the trustee has committed a serious breach of trust; (ii) the lack of cooperation among co-trustees substantially impairs the administration of the trust; (iii) the trustee has not effectively administered the trust because of the trustee's unfitness, unwillingness or persistent failures; or (iv) there has been a substantial change of circumstances.[16]

BURIAL INSTRUCTIONS IN THE WILL

Since the Will may be in a locked safe deposit box or otherwise not immediately accessible, it is recommended that the testator's wishes regarding burial are communicated to family members in advance of death. Moreover, any written instructions should be contained in a separate memorandum, which is easily accessible at the time of death. The instructions should be signed at the end of the document, witnessed and dated, so as to comply with the requirements for a valid Will contained in PEF Code Sec. 2502. The instructions can direct, for example, where the services are to be held, where the body is to be interned, and out of what fund the funeral expenses will be paid.

16. UTA §7766.

DISPOSITION OF BODILY PARTS IN THE WILL

Likewise a testator wishing to make a donation of bodily parts should also make the provision outside the Will, preferably by utilizing donation cards.[17]

FAILURE TO PROVIDE FOR PETS AFTER THE TESTATOR'S DEATH

A comprehensive estate plan should address the care of pets after the testator's death. A trust funded with sufficient assets to care for the pet after the death of the owner should be considered. The trust at least should address the following issues: (i) the amount of caretaking funds; (ii) the designation of the caretaker-beneficiaries; (iii) the designation of the trustee and its duties; (iv) the standard of care for the pet; and (v) guidance for euthanizing the pet.

The client might also consider incorporating appropriate provisions in his or her durable power of attorney in order to deal with the care of pets in the event that he or she becomes incapacitated during his or her lifetime. The following is appropriate sample language:

"My agent shall be further authorized to exercise the powers granted hereunder to provide for the reasonable care and maintenance of my pets."

FAILURE TO PLAN FOR DIVORCE IN IRREVOCABLE DOCUMENTS

PEF Code Sec. 2507(2) provides that if a testator is divorced after making a Will, any provision in the Will favoring or relating to the former spouse becomes ineffective for all purposes, unless it appears from the Will that the provision was intended to survive the divorce. Although modification under PEF Code Sec. 2507(2) only applies to Wills, transfers at death by revocable trusts and by other conveyances are similarly protected. The provision does not apply to irrevocable trust however. Such trusts should therefore include a provision like the following:

"XIII. <u>Divorce or Separation</u>.

Any provision in this Agreement to the contrary notwithstanding, in the event the Settlor and the Settlor's Spouse become divorced, separated pursuant to a court decree or formal separation agreement, under the laws of any jurisdiction inside or outside the United States of America, or are living separate and a part at the time of Settlor's death, then for purposes of this Agreement (i) such divorce or separation shall be the equivalent of his prior death; (ii) all his powers and interests, beneficial and otherwise, in this Trust, including his right to serve as Trustee hereunder, shall cease; and (iii) all subsequent beneficial interests of others shall accelerate and take effect in possession and enjoyment according to the provisions of this Agreement as if the Settlor's Spouse were then deceased."

---

17. The rules and procedures governing the gift of a body or bodily parts for medical research and education or transplantation are contained in the Pennsylvania Anatomical Gift Act. PEF Code §§8601-8624. The Act applies only to anatomical gifts that take effect on death. A "donor" is defined in the Act as an individual who makes a gift of all or part of his or her body. PEF Code §8611. A person must be of sound mind and at least eighteen years of age to make an anatomical gift. PEF Code §8602(a).

In order to expedite successful transplantation or donation after the donor's death, it is recommended that a donor carry a donor card, other document of gift, or identification card or driver's license that identifies the person as an organ donor. Moreover, the donor should inform all family members, as well as his or her physician, of an intended anatomical gift so that on the donor's death the appropriate medical authorities can be notified. Donations of bodily parts can be accomplished either through testamentary documents or by *inter vivos* gifts.

FAILURE TO AMEND THE WILL AFTER MARRIAGE

Section 2507(3) of the PEF Code provides that if the testator marries after making a Will and subsequently dies, the surviving spouse will receive the share of the estate to which a spouse would be entitled if the testator died intestate, unless either the Will gives the spouse a greater share or it appears that the Will was made in contemplation of marriage to the surviving spouse.

The effect of PEF Code Sec. 2507(3) is to preserve the spouse's intestate share without forcing the spouse to elect against the Will under PEF Code Sec. 2203(a). This is significant because otherwise the spouse would only be entitled to a one-third (1/3) elective share, rather than one-half (1/2) of the estate available to the spouse under the rules of intestate succession. The modification by subsequent marriage provisions apply only to assets passing under the Will. Unlike PEF Code Sec. 2507(2) (the provision dealing with divorce) there is no similar provision allowing a spousal share in assets transferred at death under conveyances made subsequent to the marriage, such as revocable trusts. This is one area where the revocable trust has some advantage in reducing the rights of a surviving spouse. Of course a Will executed after the marriage or a marital agreement may also address the issue. Note, however, that a marital agreement that relinquishes the right to elect against the Will as provided in Sec. 2203, may not in itself be sufficient to relinquish rights under Sec. 2507(3).

FAILURE TO AMEND THE WILL AFTER A BIRTH OR ADOPTION

Under Pennsylvania law, a testator is free to disinherit his or her children. In order to avoid the inadvertent disinheritance of a child, Pennsylvania law provides for certain child rights. If the testator failed to provide in the Will for a child born or adopted after making the Will, unless it appears from the Will that the failure was intentional, such child shall receive from the property not passing to the surviving spouse the share the child would have received if the testator died unmarried and intestate, owning only that portion of the estate not passing to the surviving spouse.[18] The modification provisions for after-born children apply regardless of whether the child is adopted or born out of wedlock.

DEALING WITH LOST AND MISPLACED WILLS

Keep an executed copy of the Will. A photocopy may be probated where the original was not in the possession of the decedent and the contents can be proven by photocopy and testimony of the scrivener.

FAILURE TO PLAN FOR THE DISPOSITION OF NON PROBATE ASSETS

Often overlooked in the estate planning process is the disposition of non-probate property in a manner consistent with the estate plan and the client's intent. The client should be asked to produce current designation of beneficiary forms in regard to all life insurance policies, IRAs, 401ks, other retirement accounts and non-probate assets. In reviewing these documents, pay attention not only to who has been named as the primary beneficiary (i.e., the person first in line to receive the dispo-

18. PEF Code §2507(4).

sition if the owner dies) but also the manner in which the contingent beneficiary is designated.

Typically a client's Will may provide that in the event that his or her spouse does not survive them, the estate should be divided equally among their children. The Will may provide further that if one of the children does not survive the client, the share of the deceased child is to pass in equal shares to the children of the deceased child. The Will provision may be worded as follows:

". . . to my wife, MOLLY, if she is then living, otherwise to my children, THOMAS, MARY, and WILLIAM, in equal shares, provided that if a child of mine does not survive me, the share that would have otherwise passed to such child shall pass to his or her then living descendants in equals shares, per stirpes."

Often the designation of beneficiary forms in regard to the life insurance, for example, of that same client provide that if the spouse does not survive, the life insurance proceeds are to pass to children individually named, without mention of a gift over, per stirpes. The wording may look like the following:

"Primary Beneficiary:my wife, MOLLY.

Contingent Beneficiary: my children, THOMAS, MARY, and WILLIAM."

In such a case if one of the children does not survive, only the surviving children will likely receive the proceeds of the insurance policy. The children of the deceased child would receive nothing. This may not be what the client wants. In order to prevent such an inconsistency—the dispositions of the all of the non-probate assets should be reviewed.

FAILURE TO RESERVE A LIFE ESTATE IN PERSONAL RESIDENCE

In some cases an unmarried couple may live together in a personal residence which is owned by one of the parties in their name alone. Failing to provide for the right in the non-owner to remain in the property for a limited period of time after the death of the owner can prove problematic. Adding a provision like the following can solve this problem.

"a. To the extent that I have the right to do so at the time of my death, I devise my real property 100 Hemlock Rd., Hemlock, Pennsylvania, to my friend, JOSEPHINE SMITH, without liability for waste for her life, so long as she occupies such property as her principal residence and pays all costs of maintenance thereof, including but not limited to, taxes, insurance, repairs, water rent, sewer rent, and heat, said property to be insured in a reasonable amount insuring the interest of the remaindermen, as well as herself.

b. Upon her death, or her failure to so occupy such property or her failure to pay such costs, such compliance to be determined in the sole discretion of my Executor, such property shall be sold and the net proceeds added to the residue of my estate distributed under paragraph II.C., below."

NO BUY-SELL AGREEMENT

A buy-sell agreement is a contractual agreement among the owners of a business (the shareholders of a corporation, the partners of a partnership, or the members of a limited liability company) which restricts the right to transfer the ownership interests and establishes certain purchase and sale rights and obligations upon the occurrence of certain events. A buy-sell agreement may achieve one or more of the following objectives:

(i) *Restrictions on Transfer*—by restricting the transfer of an ownership interest outside the ownership group, a buy-sell agreement can help the owners control and restrict who is part of that group;

(ii) *Provides Liquidity*—if the agreement provides a purchase obligation in the event of death of an owner and that obligation is funded with life insurance, the agreement can be used to convert the deceased owner's equity interests into cash; and

(iii) *Fixes Value*—by fixing the price which applies in the event of a purchase under the terms of the agreement, the estate tax value of the equity can in many cases be fixed in the estate of a deceased owner.

In order to achieve these objectives, the owners of the business must of course have a binding buy-sell agreement in place. If no agreement exists, the ownership interest of a deceased owner will pass according to the disposition of his or her estate.

Even if such an agreement exists, a common problem is that the purchase price may be originally based upon an agreed value as stated in the agreement, and then not adjusted later as the business increases or decreases in value. A solution might be to provide that the agreed upon price will be reviewed and adjusted on at least an annual basis by the parties. Further the agreement might provide that, if the price has not been updated within a stated time frame, the price will then be determined by an alternative method such as a formula or appraisal.

FAILURE TO ADDRESS "LIVING PROBATE"

The estate plan should address what happens if the client is unable to handle his or her own financial affairs because of mental or physical disability. Also the estate plan should address what happens if the client is not able to participate in decisions in regard to their own physical well being. The law provides that in either of these circumstances a legal guardian must be appointed. This process is sometimes called "Living Probate", and should be avoided.

It is easy to avoid Living Probate. All the client has to do is adopt a Durable Power of Attorney and a Medical Power of Attorney. If the client has adopted such powers, Living Probate is avoided and the people that the client selects will be in charge of his or her affairs in the event of disability.

FAILURE TO PLAN FOR THE FEDERAL ESTATE TAX

Based on the assumption that the federal estate tax will return in some significant form in 2011, and perhaps even in 2010, a failure to address the federal estate tax in estates with a value in excess of the federal estate tax exemption ($3,500,000, in 2009) is a major blunder, particularly for a married couple. If the estate is large enough to be exposed to the federal estate tax, the estate plan should be structured to reduce or avoid the tax. A married couple can often reduce or eliminate the impact of the federal estate tax entirely by the adoption of an estate plan which includes a special trust, sometimes called a "By-Pass Trust" or "Credit Shelter Trust".

A Credit Shelter Trust is a trust either created in the Will of the first of the married couple to die or as a separate trust document executed at the same time as the

Will. In either case, it is funded from the estate of the first to die. The Credit Shelter Trust is held during the surviving spouse's lifetime for the benefit of the surviving spouse or the benefit of the surviving spouse and the surviving children. If properly drafted, the assets held by the Trust will not be taxable in the surviving spouse's estate for federal estate tax purposes. Under the Internal Revenue Code, the amount that may be placed in a Credit Shelter Trust tax-free by the estate is limited to the amount of federal estate tax exemption not utilized during lifetime. Upon the death of the surviving spouse, the property held by the Credit Shelter Trust will pass, again free of estate tax, to heirs determined by the Trust (which, in most cases are the surviving children), either outright or in further trust.[19]

OVERFUNDING OR UNDERFUNDING THE ESTATE OF THE FIRST SPOUSE TO DIE

Even if a Credit Shelter Trust is part of the estate plan, the effectiveness of the Credit Shelter Trust in reducing the estate tax liability of a married couple is limited by several factors. First, as already mentioned, the maximum amount that can be placed in the Trust under the Internal Revenue Code without incurring federal estate tax upon the death of the first spouse is an amount equal to the decedent's remaining federal estate tax exemption. Second, the documents creating the Credit Shelter Trust must be in place prior to the death of the first of the married couple to die. Since it is generally not possible to determine with certainty which spouse will die first, both the husband and the wife should have documents providing for a Credit Shelter Trust.

A potentially limiting factor to the effectiveness of the Credit Shelter Plan is the amount of property owned outright by the first of a married couple to die. Even though the Credit Shelter Trust can shelter an amount equal to the federal estate tax exemption in both estates, the Code requires that the Trust be funded by assets owned by the first spouse to die at the time of their death. Therefore, part of the estate plan should be to review whether each spouse has sufficient assets in their name alone to fund the Credit Shelter Trust. There is a simple rule of thumb: if the estate of both spouses has an aggregate value of twice the federal estate tax exemption or more, then each spouse should own assets with a value at least equal to the federal estate tax exemption amount in their individual names alone. If the value of the estate is less than that amount, then each spouse should own one half of the combined estate in their name alone.

If the first spouse to die owns assets in their own name alone insufficient to fund the Credit Shelter Trust up to the exemption amount, a possible solution in some cases is to add to those assets by in effect "un-jointing" joint property. This can be accomplished through the use of a "qualified disclaimer" executed within nine months of the date of death by the first of the married couple to die. The disclaimer will in effect throw one-half of the un-jointed property back into the probate estate of the first spouse to die, and make it available to add to the Credit Shelter Trust.

19. Example One: Assume your clients are a married couple, Bill and Ruth. They have two children. Bill and Ruth have a probate estate valued at $6,000,000. $4,500,000, is owned by Bill outright in his name alone and $1,500,000, is owned by Ruth outright in her name alone. Lets assume Bill and Ruth have an Estate Plan providing that on the death of the first of them to die everything passes to the survivor and then upon the death of the survivor to the children, in equal shares. Assume further that Bill dies first. In this case Ruth would inherit Bill's assets without federal estate tax. This is because his estate passes to a surviving spouse, and by reason of the Marital Deduction, the property in his estate is not taxed. On Ruth's death, the entire estate of $6,000,000, i.e., $4,500,000 received from Bill, and the $1,500,000, she owns in her own name is fully taxable, and a federal estate tax of $1,225,000, is incurred.

OWNING LIFE INSURANCE

If an individual dies owning the incidents of ownership in a life insurance policy, the face value of the policy is fully includable in their federal gross estate. As an alternative, consideration should be given to having the policy owned by an irrevocable life insurance trust. The irrevocable insurance trust or "ILIT" can prove a valuable estate planning tool, and if properly structured can effectively remove the life insurance from an insured's taxable estate with very little or no gift tax consequence.

An individual who already owns a life insurance policy may transfer that policy to the ILIT or, if an individual has not already acquired a policy, he or she could create the ILIT and have the trustee acquire one or more policies on his or her life in the name of the trust. Under either scenario, the ILIT will be both the owner of the life insurance policy and the beneficiary of the proceeds, and it will not be taxed as part of the insured person's estate. In the case of an existing policy, this does require that the transferor survive for three years after the transfer. From a gift tax point of view, the transfer of the policy is generally a taxable gift, but its value is based on the cash surrender value of the policy and not is face value.

DISPOSING OF S CORPORATION STOCK

If stock in an S Corporation passes at death into an ineligible trust the S Election may be lost. Only certain trusts, specifically "qualified sub-chapter S trusts" and "Electing Small Business Trusts" qualify as S Corporation shareholders. In order to prevent the loss of the S Election a provision like the following should be added to the estate planning documents:

"THIRTEENTH: Special Provisions for S Stock.

(a) My Trustee may at any time hold stock of an S Corporation as defined in the Internal Revenue Code (hereinafter "S Stock"), make an election to have any corporation treated as an S Corporation, enter into agreements with other shareholders relating to transfers of S Stock or the management of the S Corporation, and allocate amounts received and the tax on undistributed income between income and principal. My Trustee may allocate the tax deductions and credits arising from ownership of S Stock between income and principal. In making any such allocations, my Trustee shall consider that the income beneficiary is to have enjoyment of the property at least equal to that ordinarily associated with an income interest and in all events shall provide the required beneficial enjoyment to the income beneficiary.

(b) Notwithstanding anything herein to the contrary, my Trustee may at any time divide any trust hereunder which has a single income beneficiary into two separate trusts, one trust consisting of all S Stock and the other trust consisting of the remaining assets. Each such trust shall be held under the terms hereunder applicable to the trust so divided, except that (i) there shall be no power in the trust consisting of S Stock to make payments of principal during the lifetime of the income beneficiary to any person other than the person then entitled to receive the income, (ii) all income of the trust consisting of S Stock shall be paid to the income beneficiary at least annually and (iii) all income of such trust accrued or undistributed at the death of the income beneficiary shall be payable to his or her estate. The trust consisting of S Stock shall at all times have only one current beneficiary and shall not be recombined with the other trust upon the exchange of any S Stock for other assets, but shall at all times after its creation permit payments of principal only to the then-current income beneficiary.

(c) Any provision of this Agreement which may appear to conflict with my intention that any trust containing S Stock qualify as a Qualified Subchapter S Trust as defined in Section 1361(d) of the Internal Revenue Code shall be construed so as to accomplish that intention. If my Trustee, in my Trustee's sole discretion, determines that such intention might not be accomplished, my Trustee shall have the power to amend the trust to accomplish said intention, subject to the following conditions and limitations:

1. No such amendment shall be made except to accomplish the intentions set forth in this subparagraph (c).

2. All such amendments shall be in the form of a decree of the court having jurisdiction over the trust, upon petition by my Trustee and after such notice to the parties in interest as such court may direct.

3. My Trustee shall have the power to request that any such amendment take effect as of the effective date of this trust, or any subsequent date, in my Trustee's sole discretion."

NO CASH TO PAY THE ESTATE TAX

If an estate does not have sufficient cash to pay the federal estate tax, the IRS can exercise discretion in permitting the deferral of estate tax liabilities in circumstances that do not otherwise qualify for postponement. Under IRC Sec. 6161, the IRS can extend the time for paying the tax for a "reasonable period" not to exceed 12 months. The effect of a 12-month extension is to make the tax due 21 months after death. Upon the expiration of the extension period, the estate may apply for another extension. The IRS can grant an extension of the time to pay estate taxes for up to 10 years if "reasonable cause" exists.[20]

In an estate in which an interest in a closely held business or businesses is included and valued at more than 35% of the adjusted gross estate, IRC Sec. 6166 also provides for an extension of time for the payment of estate tax. If Sec. 6166 applies the executor may elect to pay part or all of the estate tax in two or more (but not more than 10) equal installments. The payment of estate tax can be deferred for as long as 14 years from the date the estate tax return is due to be filed if the benefits of Sec. 6166 are elected in a timely manner by the taxpayer and the IRS approves the election.

20. *See* IRC Sec. 6161.