Top 10 Estate Planning Misconceptions

By Jane Frankel Sims, Esq.

1. WE OWN EVERYTHING JOINTLY, SO WE DON'T NEED AN ESTATE PLAN

Joint ownership between husband and wife is a sufficient estate plan in the limited circumstance where spouses are only concerned with benefiting one another and the total value of the combined estate is well under $1 million. Joint ownership does not address the disposition of assets upon the death of both spouses or the minimization of estate tax.

2. ALL OF MY PROPERTY WILL BE DISTRIBUTED BASED ON THE TERMS OF MY WILL

Property transfers upon death in three ways: by title, by beneficiary designation and by will. Titles trump wills. If your home represents the majority of your net worth and you title it jointly with your second spouse, most of your wealth will pass by title to your second spouse, even if your will leaves everything to your children.

3. THE BENEFICIARY DESIGNATIONS ON MY RETIREMENT ACCOUNTS DON'T MATTER AS LONG AS I HAVE A WILL

Retirement accounts, such as 401(k)s, 403(b)s and IRAs, represent a significant portion of most estates. You should make sure that the beneficiaries you have designated on your retirement accounts reflect your testamentary wishes. Your will may leave everything to your spouse and children, but if you still have your sister designated as beneficiary of the IRA you opened 15 years ago, your sister will inherit the IRA assets.

4. THERE'S NO DOWNSIDE TO ADDING A JOINT OWNER TO MY BANK ACCOUNT AND THE DEED TO MY HOUSE

Many people choose to add one of their children as joint owner of their bank account so that the child can pay bills and manage the assets in the event of a disability. They do not often realize that adding a joint owner to a bank account means that the account will pass automatically to the joint owner upon death, rather than pass equally to all of the children pursuant to the terms of the will. When confronted with this reality, many clients insist that their child will distribute the assets fairly among the siblings. However, there is no legal obligation to do so and such a division often does not occur.

Adding a joint owner on the deed to your house poses the same problem, as well as a few additional difficulties. Putting a child's name on a title represents a gift to that child. When the child sells the property after the parent's death, he or she will owe capital gains tax on the difference between the value of the house at the date of the original gift and the value upon sale. Furthermore, adding a child's name to a deed subjects the property to any creditors of the child due to lawsuits, divorces or defaults.

5. ONLY MILLIONAIRES HAVE ESTATE ISSUES

In Maryland, each person can pass $1 million free of estate tax. Most of us do not have $1 million in the bank. However, the equity in your home, life insurance proceeds, IRA/401(k) accounts, bank/brokerage accounts, closely held businesses and tangible personal property all fall into the $1 million bucket. Proper planning can ensure that the exemptions of both spouses are utilized, or in the absence of a spouse, tax is minimized through lifetime gifting.

6. LIFE INSURANCE PROCEEDS ARE NOT TAXED AT DEATH

This common misconception stems from the fact that cash invested in life insurance policies is not subject to income tax as it grows during the life of the insured. However, the death benefit of a life insurance policy is fully includable in a decedent's taxable estate. The estate of a person who dies while owning a $1 million term life insurance policy will be on the threshold of the Maryland estate tax before any other assets of the estate are added to the equation. A properly drafted and administered life insurance trust can mitigate this consequence.

7. I'M TOO YOUNG TO WORRY ABOUT ESTATE PLANNING

Estate planning is not just for the elderly. Powers of attorney, which appoint someone to manage your assets and make health care decisions for you in the event of disability, are an integral part of an estate plan and can come into plan at any age. An advance directive, a combination of health care power of attorney and living will, also serves to express your wishes regarding artificial life support and other end-of-life decisions. Terri Schiavo was in her 20s when her lack of an advance directive led to a prolonged and expensive court battle.

8. I CAN DOWNLOAD A PERFECTLY GOOD WILL FROM THE INTERNET

Internet will programs do not often accurately address state-specific tax laws, detailed succession planning, family dynamics or practical considerations. Similarly, having your brother-in-law, who happens to be a trial lawyer, draft your will is not a good idea due to the complexity of the estate tax and inheritance laws.

9. PROBATE IS AN AWFUL PROCESS THAT SHOULD BE AVOIDED AT ALL COSTS

Probate, the court-supervised method by which assets are transferred from the name of the decedent through the estate and to the ultimate beneficiaries, is not a difficult process in Maryland. An estate can be opened in a matter of days after death so that assets are not held in limbo. Due to the options of modified administration and small estate filings, the process is not as lengthy and expensive as you may think.

10. REVOCABLE LIVING TRUSTS MINIMIZE ESTATE TAX

It is commonly, though incorrectly, asserted that revocable living trusts are a tax-avoidance vehicle. This is plainly untrue. Revocable trusts have no effect on estate tax. However, they can avoid probate if all of a person's assets are retitled in the name of the trust during his or her lifetime.

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