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YOU DON'T HAVE ENOUGH MONEY FOR A TRUST!

The Shocking Truth About Trust-Based Estate Planning

By Jeremy C. Johnson

Recently, we have dealt with a number of situations where clients call us with trepidation to inform us that their financial advisor, or their next door neighbor who is a retired financial advisor, or their friend who knows a financial advisor, has told them that they "do not have enough money for a trust." They call us understandably confused, scared, and concerned about who they should trust.

Unfortunately, it is all too easy for these outside parties to sow seeds of doubt in the client's mind. This can be further complicated as these parties have not been involved in the detailed, systematic, and vetted estate planning process JGB uses for all of our clients. Even if the friend or acquaintance is well-intentioned, they can cause a great deal of worry. Therefore, this month's newsletter is intended to provide our client base with additional knowledge with which to combat well-intended but ultimately, bad advice.

It really doesn't have anything to do with the amount of money you have.

There, I said it. Often, people will look for the easiest classification system to determine the appropriateness of trust-based planning and settle upon the value of the client's estate. This does not require any investigation beyond, "how much do you have?" This is an inappropriate paradigm to use in determining what form of estate plan one should consider. Instead, the appropriate benchmark to use in determining the appropriate estate plan should be based on your goals and objectives. I have had clients with tens of millions of dollars whose goals and objectives dictated the use of a simple last will and testament. I have had clients with less than two hundred thousand dollars in total gross estate (including home value, IRAs and life insurance value) that created trust based estate plans because that was the planning that accomplished their stated goals and objectives. At a time where there is so much talk and discord about the benefits afforded the '1%', why would we immediately remove from the rest of us a strategy that the wealthy have used to their advantage for so long to protect and grow their family wealth?

Even after a reasoned discussion, there will always be those who still will say, "You must have an estate size criteria that you use as a rule of thumb" when it comes to using a trust based plan. When I am pushed to answer this question for those who are having difficulties grasping the larger concept

of goals-based planning versus asset-based planning, I explain as follows: For clients with gross estates under $200,000, I begin our discussion with will based planning in mind; for clients with gross estates between $200,000 and $500,000 I begin with will based planning concepts and then begin the discussion of trust based planning as a comparison point; for clients with gross estates in excess of $500,000 but less than $1,000,000, I begin discussions with trust based planning but revert to will based concepts if the situation dictates it more appropriate; and for clients with gross estates in excess of $1,000,000 I begin the discussion with trust based planning and strongly advise the client against will based planning in most instances. Remember, at the end of the day, the value of the estate is ultimately less important than making certain that the estate is administered as the client intends. Generally speaking, the trust based estate plan provides a better platform, if drafted correctly, to ensure that my client's intentions are realized in the administration and distribution of his/her estate, regardless of what that dollar value ends up being.

Probate isn't a big deal!

Clients are often told by others that "Probate isn't a big deal!" As such, they receive (often unsubstantiated) advice that avoiding probate is not worth building a trust to accomplish. While Probate may not be the pitfall that some make it out to be, the hassles of probate should still not be underestimated. In Virginia, probate can cost up to 5% of the estate value. In our experience, it takes, on average, between 6 months and 2 years to complete. Probate is also a public process. Anyone can go and look up anyone else's probate to see: 1) what was in the estate, 2) to whom they owed money, 3) to whom they left their assets, 4) the ages of the beneficiaries, 5) where the beneficiaries live, and 6) when do they receive the assets. In addition, by nature of being a public process, anyone can file a contest/claim against the estate. Even a creditor of the decedent can petition the Court to become the Personal Representative ("Executor" equivalent) of the estate in question.

I am not saying that every probate estate experience will hit on all the bad parts of the probate process. However, when a probate does go badly, it has a tendency to go very badly.

You don't need an attorney or a trust to avoid probate; you can do it yourself with joint ownership and beneficiary designations.

I hear this far too often. You certainly can go this route. But, before you do, let's dissect these strategies to understand the good, bad and ugly. First, let's discuss joint ownership with right of survivorship. This form of ownership can be useful. We even recommend it on certain assets for our trust clients. However; we are careful about which assets are designated as joint with right of survivorship, as these assets are subject to various potential administrative and distribution issues.

Jointly owned assets create a 'financial marriage' between you and the other owner. This means if you place your account in joint ownership with right of survivorship with your son or daughter and they get divorced or sued, your asset is now included with their assets for the divorce or judgment.

If you have your house in joint ownership with your spouse and one of you becomes incapacitated, necessitating the need to move equity out of the real property in the form of a loan from the bank, the non-incapacitated spouse will not be able to complete the loan transaction by themselves on the

basis that the property is held jointly. Very few reputable banks would enter into that deal. Even worse, if the house needs to be sold and the couple now needs to move into an assisted living facility, the non-incapacitated spouse does not have the ability to sell the real property on their own, even though they are one of the joint owners.

Then there is the Tom and Ann story I tell during my instruction classes when we get to the topic of joint ownership. Tom and Ann are a nice couple, in a first marriage with all common children from that marriage and everything is in joint ownership with right of survivorship. Nice and simple, right? Wrong. If Tom dies, there is no probate on the assets at his death, because there is nothing in his name alone at his death. Everything becomes Ann's, immediately. However, when Ann eventually passes, everything is solely in her name and therefore, subject to probate. Tom and Ann didn't avoid probate in this example, they only deferred it.

But that's not my main concern with the above hypothetical. My main concern is that Ann remarries and she puts all of her and Tom's assets now in joint ownership with the tennis pro at the club; we'll call him Ken. Now, it may feel right to Ann to have done this with her assets because married people are supposed to own stuff jointly, right? Not necessarily. Ann and Ken are in a blended marriage. As such, it is a primary imperative to make certain that asset ownership is structured carefully to avoid 'unintentional disinheritance.' You see, if Ann now dies, all of the assets she and Tom amassed during their life together now immediately transfer to Ken. Ann and Tom's kids are now completely disinherited. Even if Ken wanted to be a nice guy, tax law limits the amount he can gift back to Ann and Tom's kids.

It is my opinion that in any estate plan (trust-based or otherwise) there may be a place for joint ownership of assets. However, the use of joint ownership must be thought through and discussed so that the parties understand the various possible consequences involved.

With regard to beneficiary designated assets; provided that the beneficiary is 1) alive, 2) not incapacitated, and 3) not a minor, the asset will generally avoid probate/guardianship. However, if the beneficiary fails any one of those tests at the time of distribution, there will be a probate or guardianship. There is another set of issues that must also be considered with beneficiary designated assets. Namely: 1) will the asset received be part of the beneficiary's asset base for lawsuit and/or divorce purposes, 2) does the beneficiary have the ability to manage that asset and use it wisely, 3) what happens to that asset if the beneficiary dies? The simple solution of, "Just put a beneficiary on the account" seems attractive at first; but when you start drilling down deeper the simple solution may not actually meet your goals and objectives. In addition, you almost never want to list your beneficiary as 'my estate' as this will most assuredly trigger a probate on that asset. To make matters worse, if it is a tax deferred asset, like an IRA, this will cause a fundamental failure in its ability to be 'stretched' over the life expectancy of the beneficiary for required minimum distribution (RMD) purposes.

You don't have a taxable estate, so you don't need a trust.

The current federal estate tax exemption is $5,340,000 for an individual. Most people don't need trusts for federal estate tax purposes at this time. However, can you or the person providing you this advice guarantee that the federal estate tax exemption is not subject to change in the future?

How much faith do you have in either Congress or your state legislature acting in your best interest over the long term? I believe that if I can control a factor in my life for myself by proper planning, I should do so, rather than hope that the federal or state government will take care of me. Trusts do provide us with opportunities to build safety measures for tax planning purposes. However, those people who focus on trusts only for tax planning purposes are missing the larger point. Most of what I use trusts for with regard to my clients has ultimately very little to do with taxes but everything to do with protecting the asset base for the client's family while minimizing transfer cost and exposure to external liabilities that have a way of separating the assets from the family if left unchecked.

<u>I'm sure your Plumber gives great medical advice</u>.

Every year, I continue to be amazed by the stories I hear about people taking the wrong advice from the wrong people. In many cases, the person imparting the advice is well-meaning. However, it does not matter how pure the intention if it is not coupled with proper experience, licensing, and liability insurance. Virginia (as well as most other states) has something called the Unauthorized Practice of Law provision (Rules of the Supreme Court of Virginia Part 6, Section 1). The preamble begins "The right of individuals to represent themselves is an inalienable right common to all natural persons. But no one has the right to represent another, it is a privilege to be granted and regulated by law for the protection of the public." This should never be taken lightly. Any person found in violation of this may be found guilty of a misdemeanor. Advice on the legal impacts of a legal document is the practice of law *per se*. Therefore, if someone other than a licensed attorney is providing you with advice on the effectiveness, necessity and/or or construction of a last will and testament or a trust, they are providing you with legal advice in violation of the UPL provision. Ask yourself, would you want your surgery conducted by someone without the proper medical boards and training? No, of course not. Your estate planning advice should be acquired, similarly, by an appropriately licensed attorney who has the skill and experience to attend to your legal needs.

<u>Mea culpa, mea culpa, mea culpa</u>.

I apologize for the uncharacteristic length of this edition of our newsletter. Selfishly, it has served as an engine of catharsis. Hopefully, this newsletter provides you with a helpful insight into some of the daily issues, concerns, and questions we regularly field in the execution of our profession as estate planning attorneys. Our advice continues to be that each of you should take all prudent steps to protect yourself and your family. Please do not hesitate to call us with questions about your plan.

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Jeremy Johnson is an experienced problem solver who helps individuals and businesses achieve and protect their goals of prosperity, stability and growth through appropriate planning. Jeremy takes great pride in making sure that his work for clients is always reliable, correct, and on time.

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