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Focus

Finding Common Flaws in Estate Plans

by Nancy Opiela

In Lewis Carol's [Through the Looking Glass](#), Humpty Dumpty tells Alice, "When I use a word, it means just what I choose it to mean—neither more nor less." Too bad that pronouncement doesn't apply to estate planning. If it did, there would be no need for financial planners to double check new clients' estate plans. Everything would be exactly as the clients had intended. In reality, however, planners report that even the best-laid, well-paid-for estate plans have a myriad of problems, often resulting from poor drafting or a misunderstanding between their clients and attorneys. And these issues are compounded by changes in tax laws and in clients' lives.

Before joining William Blair & Company in Chicago, Illinois, Michael Lee, J.D., CFP®, was an estate planning attorney. Today he says many prospective financial planning clients arrive at his door with all the "estate planning bells and whistles," yet don't understand how they work. Lee says, "As we talk about their estate plans, clients will often remark, 'That's not what I want' or 'I don't like that idea.'"

Lee says the value planners can add in the estate planning process is to help clients integrate all the pieces of the puzzle and arrive at a plan that accomplishes what they want.

"As an estate planning lawyer, I rely on financial planners to spot issues because they have a closer, more consistent relationship with the client than the lawyer does," says Jon Gallo, J.D., of the Los Angeles law firm of Greenberg, Glusker, Fields, Claman & Machtinger. "I don't expect planners to know the details of a family limited partnership or a qualified personal residence trust any more than they would expect me to give advice on asset allocation. For the client's benefit, however, it is very important for our two professions to cross-fertilize."

In fact, planners interviewed for this story say unearthing estate planning problems can be as simple as asking a handful of questions that often raise red flags.

1 — Do You Have a Will?

When asking whether a client has a will, planners say it is a mistake to accept yes for an answer and move on. Because minor mistakes can cause big problems, planners say a quick review of the will is always in order. "Every client wants a simple will, but it's never simple," says David Kauffman, J.D., CFP®, of Ferris Baker Watts in Rockville, Maryland. "I tell clients that hopefully the document is going to be used 30 years or more into the future and that a thousand things could happen between now and then—not even accounting for the changes in estate tax laws. So our approach is to hope for the best, but plan for the worst. Often that requires additions to the client's will."

For example, Anneliese D'Souza, CFP®, of D'Souza Financial Strategies in Frederick, Maryland, says 80 percent of the wills of married couples she reviews do not address the possibility of simultaneous death. She explains, "If a will doesn't address simultaneous death, each spouse is presumed to have died before the other and that leads right into a tax trap. If there was any marital property that would normally qualify for the marital deduction, they would lose that deduction. This problem is magnified if the husband and wife own property jointly with rights of survivorship. In that case, not only would they lose the marital deduction, but there could be probate problems."

D'Souza says addressing the issue of simultaneous death is especially important if there is a big disparity in the value of the estates. "If the husband's estate is \$2 million and the wife's is \$500,000, the clause we'd introduce would say that in a case of simultaneous death, the husband would be presumed to have died first. Then we could exclude \$1.5 million and transfer \$500,00 to the wife so she has a total of \$1 million, which is exempt from estate taxes. Without that simultaneous-death clause, nobody benefits from the exclusion."

Interestingly, D'Souza says that even when the issue of simultaneous death is addressed, sometimes it is

addressed incorrectly. "An attorney recently drafted a living trust for a couple I work with and although he included a simultaneous-death clause, it said that in the instance of simultaneous death, each spouse would be presumed to have died before the other—the exact situation we want to avoid. In this case, because the husband has far more assets than his wife, he should be presumed to have died first."

D'Souza also notes that many wills she reviews do not include disclaimers. "It's not simply a matter for high net worth clients," she says. "Nobody knows what will happen in the future. Maybe the wife inherits \$3 million and at the time of her husband's death she doesn't want to receive anything additional into her estate. The will needs to be worded properly for her to be allowed to disclaim the inheritance."

Although Kauffman stresses the need for wills to be comprehensive, he says it is a mistake for clients to address funeral and burial arrangements in their will. He explains, "I heard about a situation where, after the funeral, the will was taken out and the family discovered that they had not buried the deceased according to his wishes. Rather than include those instructions in a will stored in an inaccessible safe deposit box, I suggest that clients have an additional document and discuss their wishes with the friends or family members they ask to keep the document."

Finally, Christopher M. Duffy, J.D., CFP®, of Capital Analysts of New England in Quincy, Massachusetts, has seen a number of issues arise with the pre-packaged wills available online. In particular, he's seen a number of cases where these documents are improperly executed. "I've seen the mistake of a notary signing as both the notary and a witness on the client's will, and another instance where the client signed as witness to his spouse's will and vice versa when they were each other's beneficiaries," Duffy notes.

2 — How Are Your Assets Titled? Do You Understand the Tax Impact?

Planners report that outdated beneficiary designations on non-probate assets such as IRAs and 401(k)s are a near-universal problem. In fact, Duffy reports that the response to his question, "Who are your beneficiaries?" is often an embarrassed "I don't know." He explains, "Clients get married and it is no longer appropriate to list their parents or brother or sister as the beneficiary of the account, but few clients ever get around to making those changes."

Todd Amacher, J.D., CPA, CFP®, of Robertson, Grieger & Thoele in Dallas, Texas, says: "A client can have a great estate plan with assets in a trust for children, but maybe the majority of his net worth is going to pass through an IRA to a person he forgot he named as a beneficiary, or to his children outright."

To avoid surprises, Amacher suggests to his clients that every few years they request copies of their beneficiary forms. "With all the mergers and acquisitions in the corporate world, beneficiary forms can get lost," he says. "And in that case, your beneficiary becomes your estate and assets likely will have to be paid out over five years. If there's a beneficiary designated on the form, however, the client's heir can realize the benefits of long-term tax deferral."

D'Souza notes that many new clients who have named minors as beneficiaries of a qualified plan, or even listed a minor as a contingent beneficiary, have failed to name a guardian for them. "The courts' view is that money left to a minor should be put in a savings account until that person is age 18," she explains. "I tell clients there could be a case where for ten years or more, half a million dollars sits in the bank earning next to nothing. To afford your beneficiary better investment options, name a guardian instead or a living trust."

Gallo says the most common mistake he uncovers with new clients involves how titles to property are held. "People sometimes think they are being efficient or clever, but the bottom line is, without proper advice, they create problems for their estate," he says.

For instance, Gallo notes that many new clients mistakenly think their payable-on-death bank accounts qualify as completed gifts to their children when, in reality, they have not moved the assets out of their estate.

Gallo also says people often put their children on the title to their home, not realizing that it's a taxable gift and in some states could trigger a property tax re-assessment. Explains Gallo, "There is a distinction drawn between bank or savings accounts and stock certificates and real estate. With bank accounts, you

can list another name along with yours and there has been no completed gift until the person makes withdrawals from the bank account. The thinking there is that you could beat them to it and take all the money out yourself, so there's nothing to say that the second name on the account is ever going to get anything. On the other hand, if you register 100 shares of Microsoft in two names, you have made a completed gift—half interest in those 100 shares. And if you put your child's name on your house, you have made a gift of half-interest in your home."

Is there a remedy for this mistake? "The first issue is to determine what the client thought he or she was doing," Gallo says. "Maybe they really intended to make the gift. Then we say, 'Okay—you didn't file a gift tax return, you didn't file a re-assessment form with the county assessor, which is required in California. Now we need to go back and get it done correctly and try to get all the authorities to accept what you have done and accept the fact you were not intentionally avoiding the law, so there will be no penalties.'"

Gallo continues, "If the client viewed putting the child's name on the title not as a gift, but as a convenience to help manage the property, and the child never understood that it was a gift, we would prepare a declaration by all of the parties saying this is what was intended. This allows us to get the property titled again in the proper form."

Gallo adds that a qualified personal residence trust (QPRT) is often a good vehicle to transfer an interest in a personal residence to children. "Yet once half-interest in the house belongs to the child or children, the parents should be paying rent to their children because they own half of the house," he notes.

Life insurance is another titling issue. Cynthia Zalewsky, CFP®, of Saratoga Investment Solutions in Saratoga Springs, New York, notes that much of the time clients own life insurance in their own name and fail to factor the death benefits into their estate. Accordingly, their estates may end up being large enough to require more sophisticated planning, including the use of a bypass trust.

"In our area, the cost of living is so high, many clients have \$500,000 to \$1 million in Life insurance. If the policy is in the client's name, that can create an estate tax issue," says Zalewsky. "For an older client, we might choose to set up an irrevocable life insurance trust, but it's less clear what to do for younger clients. We could transfer the policy to a spouse, but what happens if they get divorced? The best option depends on the client's situation."

Another blunder Zalewsky often finds involves the per-stirpes designation. "Clients often want to ensure that assets that go through beneficiaries go to their blood family—that is, their son or their grandchildren rather than their son's wife—but when we explain to a fund company what we want to do, the company often sends a change-of-beneficiary form that may not have the per stirpes designation listed as an option. In that case, the client can end up writing something in that may not be accurate. In fact, fund companies often have a completely separate form for this designation."

3 — If You Have a Trust, Did You Fund It?

Randy Gerard, CFP®, of Bank of Blue Valley in Leawood, Kansas, has reviewed numerous estate plans where the client had created a living trust but never funded it.

"In these situations, I immediately contact the clients and tell them we have an urgent matter to discuss. My message is, 'You've done a wonderful job here. You have taken all the right steps, but the trust isn't funded. If something happens tomorrow, you may be headed to probate, a step you were trying to avoid with the help of your attorney.'"

Gerard also finds that many clients are uneducated about trusts. He explains, "Some clients think they have a living trust, but it's a testamentary trust through the will and will not be created until after their death. It's worth the time for a planner to go through and make sure the client knows how everything will work."

Christopher Duffy adds, "Sometimes I come across a letter from the client's attorney that provides the client with details regarding the proper titling of the client's assets, but neither the client nor the attorney has followed through. The assets are still titled jointly. I stress to clients that means that if the husband owns everything and the wife dies first, their estate plan isn't going to work. And once one spouse dies,

their exemption is lost. You don't get a second chance."

4 — Have Your Power of Attorney and Health Care Power of Attorney Been Updated for HIPAA?

Planners stress to their clients that estate planning involves more than managing how their finances will be handled after their death; it also requires planning for what will happen should they become disabled. Another misconception planners battle is that a will and power of attorney are necessary only for clients with children or significant estates.

Planners say a power of attorney—a document that permits another person to make decisions regarding your legal and financial affairs in your stead—can be more important than the will because many clients have the bulk of their assets in an IRA or other qualified plan that passes to beneficiaries outside of the will.

Most financial planners recommend a durable power of attorney that goes into effect upon signing and remains in effect through any incapacity and until death, unless it is revoked. The power of attorney typically allows the agent to perform a broad range of financial transactions on behalf of the person, but there are powers, planners say, that are often omitted.

For example, John Cullum, CFP®, of Abacus Planning Group in Columbia, South Carolina, has reviewed plenty of durable-power-of-attorney documents that do not give the agent the ability to make gifts. "This causes myriad problems if the agent wants to move assets out of the estate, make charitable gifts, or fund a child or grandchild's college education," he notes.

Zalewsky adds that attorneys often use as the limit for gifting the dollar denomination allowed by tax law at the time the power of attorney is drafted, rather than stating that gifting be allowed up to the current year's gifting limits. "Two decades later, the gift-tax exemption likely will have increased, yet the power of attorney limits the agent by specifying an outdated amount," she explains. "Whether for Medicaid planning or estate tax planning, you tie the agent's hands by specifying dollar amounts. I prefer allowing the agent to make gifts based on the current gift-tax exemption amount in effect at the time of the gift."

Additionally, Cullum balks at documents that state that the "agent can do anything for me I can do for myself." He explains, "That may make sense to the person, but language as broad as that doesn't always hold up. What's more, phrases like that can be interpreted differently among companies."

The tragic story of Terri Schiavo has made it easier for planners to convince clients of the importance of the health care power of attorney that permits an agent to make medical decisions on the client's behalf. What planners say clients are somewhat naïve about, however, is the importance of the HIPAA authorization form. The Health Insurance Portability and Accountability Act of 1996 involves health care privacy laws that prevent health care providers from discussing an individual's health care information, such as whether the principal is incapacitated.

Says David Berek, J.D., CPA, of Frye Louis Capital Management in Chicago, Illinois, "In the last year, we've begun recommending both a health care power of attorney and a separate HIPAA document because springing powers of attorney may conflict with HIPAA. That is, if a health care power of attorney becomes effective upon the determination of incapacity of the principal (springs into effect, rather than being effective from date of execution), it likely will be difficult for the designated agent to communicate with health care providers because of HIPAA restrictions. If HIPAA prevents the health care provider from talking to the proposed agent regarding the principal's incapacity, the proposed agent will have to engage other methods to become empowered, typically through a court process, which generally frustrates the original intent of drafting the power of attorney."

Cullum adds, "A general durable power of attorney can include health care directives, but the administrators in a hospital are going to have to weed through a lot of information to get to what applies to them. Our goal is to make it as easy as possible for those people to find the information they need. So we advise clients to have a general durable power of attorney, a separate health care power of attorney, and the HIPAA authorization form."

He notes that health care directives and HIPAA forms should be stored at home, not in a bank safe deposit box where they are inaccessible on a weekend.

5 — How Old Is Your Estate Plan?

As works in progress, estate plans need to be reviewed every three to five years to ensure they take full advantage of changing laws and account for changes in clients' personal circumstances.

As for changes that could easily fall through the cracks, Berek points to changes in state estate-tax laws regarding the marital deduction funding formula. He explains, "Many states have 'decoupled' from the federal estate tax. A client's estate could be subject to death tax in a state—where they own real estate, for example—even though no federal estate tax is due, if a particular state incorporates a lower unified credit amount than the effective federal credit amount. If the funding formula takes into account state death taxes, as many do, the marital deduction may be unintentionally under-funded."

Accordingly, it's important, Berek says, for planners to ask clients where they own real estate.

Michael Lee adds that while changes in tax laws almost certainly prompt planners to review clients' estate plans, subtle changes in a client's life can also dramatically affect their plans. "Once an attorney drafts the estate plan, the instruction is, 'Come back when something changes in your life.' While the client may contact the attorney when there are big changes—for example, when somebody dies or a child is born—there are also what I refer to as 'slow creep' changes. For instance, nobody thinks of how their net worth has increased over the ten years it took to build their business. Planners are in an ideal position to be aware of changes in clients' financial or personal life that might warrant a re-examination of their estate plan."

6 — Have You Named the Right Executor, Trustee, or Agent?

Based on the logistical difficulties of working with out-of-state executors and trustees, Randy Gerard suggests that clients consider appointing corporate co-trustees to help handle potentially complex tax, investment, and property division issues.

Gerard says deciding whom to appoint to implement your estate plan depends on two factors. "The personal and spiritual part involving what is required for the family, if there are minor children involved, often points a client to a family member. But there are also tedious business concerns, such as the filing of the final tax return. Because these two responsibilities often require different experience and expertise, clients might consider a co-trustee to help moderate decisions," he says.

Cynthia Zalewsky points out that although most clients spend a lot of time deciding on executors, they mistakenly do not to spend an equal amount of time deciding whom to name for their power of attorney. "I tell clients their power of attorney is the most important person they will choose," she says. "The executor's job is of limited duration and is done after you die. But the person you grant power of attorney to can make life-and-death decisions for you. They may make decisions in your stead that, after you recover from incapacitation a year later, you will have to live with."

Zalewsky continues, "I remember one client telling me she wanted to name a woman in her town as her power of attorney. Trouble is, I had never heard my client say a positive thing about this woman. I advised her against this and one month later, after not taking my advice, the woman sued my client."

Finally, because your heirs may need to live with a trustee for a long time and, short of total incompetence or fraud, it is hard to throw out a trustee, David Kauffman says it's a mistake not to put conditions for dismissal in your documents.

He explains, "You can put conditions in the document: If xyz happens, the trustee can be taken out. You could say if it gets to a point where a lawyer needs to get involved for the beneficiary, it goes to arbitration, and the arbitrator decides if the trustee is the right person. Providing a way out means your heirs can avoid the emotional and financial toll of a court battle."

7 — Have You Discussed Your Estate Plan with Your Heirs?

Because keeping estate and charitable plans a secret can result in hurt feelings and heirs contesting the will, Jon Gallo advises parents to discuss their estate plans with their children.

"If you are going to treat family members unequally, you need to be aware that as a general rule, children equate the equality of gifts to equality of love," explains Gallo. "When you treat children differently, that creates huge emotional issues that translate into lawsuits. Talking to your children about your plans not only softens the impact, it also prevents the child who is getting less from believing the child who got more plotted behind his or her back. Keeping secrets, whether it's about the inheritance or the choice of an executor, is a bad idea."

8 — Is Your Plan Correct from a Tax Standpoint?

Across the board, planners complain that they see estate plans that are fantastically efficient from a tax standpoint but that don't completely reflect the client's wishes. In other cases, over time, clients fail to do what they need to qualify for the tax benefits.

Consequently, Todd Amacher is certain to stay in close touch with clients who have family limited partnerships. "If family limited partnerships are not properly administered, the client may open a window for a creditor or the IRS to attack them," he explains. "If you have a family limited partnership, you have to have your annual meeting, prepare your minutes, and you can't pay your personal bills out of that account. The IRS has been successful in attacking family limited partnerships that are not treated as a separate partnership or that were set up on the deathbed."

Other times, it's a small tax detail that needs fixing. For example, Gallo says clients often come to him with wills and trusts done by other lawyers where the client is giving \$10,000 to one heir, \$50,000 to another, and so on. Notes Gallo, "Lawyers often don't ask if the gifts are net or gross and the client doesn't think about the taxes. When I look in the body of the trust to see how federal estate taxes should be pro-rated, often I find nothing at all mentioned. Or I find that it is to be pro-rated in accordance with state law. All that means is that each bequest named in the document bears its share of taxes. If the client wants to gift a specific amount, we include something as simple as 'I give \$10,000 and I direct that all estate taxes attributable to the gift be charged against the estate' or 'All general bequests, gifts of cash, are tax-free.'"

David Berek spots problems with standard tax apportionment clauses that direct the executor or trustee to pay all taxes from residue. "While that clause works for the client who gives his daughter a ring and he does not intend for her to pitch in and pay taxes on it, if the client's estate includes trusts, the estate may be liable for the tax without the ability to access the funds," he explains.

It is important, therefore, for planners to be aware of what will generate tax and where the taxes will be paid from. Berek often suggests including a phrase in the document such as, "If there are assets includable in my estate that are not passing through, they pay their fair share of taxes."

Finally, Anneliese D'Souza finds many estates are not liquid enough to pay estate taxes. She explains, "Many people have all their assets tied up in their home and qualified plans. If an estate like that crosses \$1.5 million, where do the heirs get the money to pay taxes? They might be forced to sell the real estate or make a withdrawal from the IRA and be hit with income taxes."

D'Souza says the Roth IRA is a simple fix for clients who qualify. "It's still a retirement account, but heirs could access it without paying taxes if they had to," she says.

In Closing

Using a Roth IRA in a situation such D'Souza describes is the ideal planners and attorneys strive for because it takes the big picture into account, matches the investment vehicle to the client's goals, and leaves options open for heirs. But for estate planning in general, especially in an environment where estate laws are in flux, achieving this ideal rarely will be as easy as switching from one investment vehicle to another. In fact, over the long term, the key to successful estate plans isn't necessarily novel investment

products or tax loopholes, but planners' ability to keep the lines of communication open with their clients, uncover potential problems, and work with estate planning attorneys to find solutions that reflect their clients' wishes.

Nancy Opiela is a contributing writer to the Journal of Financial Planning and is based in Medfield, Massachusetts.

From Your Colleagues

We've compiled the common estate planning mistakes that some Journal readers shared:

Rich Bergman, CFP®
Mesirow Financial
Chicago, Illinois

- Unnecessary inclusion of family trust corpus in the estates of descendants, instead of perpetuity trusts with appropriate ascertainable standards.
- Not using Roth IRAs to fund credit shelter exemption.

William Taylor, CFP®
The Farmers and Mechanics Bank
Galesburg, Illinois

- Creating a living trust and not funding it.
- Having a real estate in another state other than resident state and not having the property in a trust.

Jonathan Moyer, CFP®
Capital Investment Advisory
Souderton, Pennsylvania

Children adding their names to their parents' accounts for convenience (to pay bills, manage accounts), only to lose out (or potentially lose out) on the step-up in basis at the parent's death.

Danielle Louton, J.D., CFP®
Galecki Financial Management
Fort Wayne, Indiana

- Not having a disposition plan for assets over the applicable credit amount.
- Not having the proper incremental amount going for final distribution.

Sheila Walker Hartwell
Hartwell Planning LLC
New York, New York

- It is common for younger clients with small children to not have any estate-planning documents in place and have no clue about the importance of them or risks of not having them.
- None of my clients have heard of HIPAA.

Cindy Gleason, ChFC, CFP®
Life Strategies Financial Services
Waterloo, Iowa

I recently attended a seminar at the request of one of my clients. The estate planning portion was put on by an attorney. He promised the attendees that if they bought his CD of forms, they could insulate themselves from any lawsuit including a dissolution of marriage; draw up their own charitable remainder trust, fund it, draw the income and pass the entire income to their heirs; save thousands of dollars by

avoiding the use of an attorney; and reduce the amount of income taxes they paid to zero. At the end of this seminar, which contained substantial amounts of incorrect information, I watched, horrified, as at least 30 people bought this CD.

Phil Calkins, CFP®, CSA
LifeCourse Advisors LLC
Princeton, Kentucky

The majority of prospective clients I interview still do not have estate distribution plans in place. They may be aware of the horror stories of others, but like many teenage drivers, they consider themselves invincible and put off this essential planning. The biggest mistake is taking no action whatsoever.

Clare Stenstrom, CFP®
Bourne Stenstrom Capital Management Inc.
New York, New York

- Powers of attorney that are so complex and limiting that banks and investment firms will not accept them.
- Medical directives that no longer reflect their beliefs (some never did).
- People appointed who are no longer viable choices (deceased, divorced, not current friend).
- Charity no longer consistent with clients' wishes.

Carolyn Bishop, CFP®
Partnervest Financial Group
Santa Barbara, California

- Having only a will when an inter vivos trust would be more appropriate.
- Inflating an estate with life insurance when it may be more appropriate to transfer it out of one's estate.
- Failure to recognize that sizable charitable gifts can trigger AMT.

Keith Newcomb
Full Life Financial LLC
Nashville, Tennessee

- Failing to follow up on a planner's advice to update an estate plan. One new client actually said, upon hearing he needed to update the wills and trusts, "My lawyer is a good lawyer and if it needed to be updated, he would have sent me a letter or called by now."
- Farmers carefully gifting the farm directly to adult children but retaining a life estate (thereby causing the estate tax benefits of the gifts to be lost).
- Failing to account for the citizenship status of each party in the marriage. The marital exemption does not work the same if the surviving spouse is a non-citizen.

Martin J. Bauer III, CFP®, CPA, PFS
Torrance, California

- Asset protection: By giving the assets directly to children, the children lose asset protection. The assets are subject to bankruptcy, divorce and creditors.
- Generation skipping tax: By giving the assets directly to children, the assets are taxed in the children's estate.
- Forcing the income from the bypass trust to the survivor.

Vern Sumnicht, CFP®
Sumnicht & Associates LLC
Appleton, Wisconsin

Putting "estate" as beneficiary on retirement accounts. The trustee will have to pay it out to the deceased

spouse's estate. Otherwise the living spouse could roll these assets into her or his IRA and continue the deferral.

Sherwin Lesk, CFP,[®] J.D., LL.M.
Leonetti & Associates Inc.
Buffalo Grove, Illinois

Beyond the usual suspects is the failure of clients to insist on having their documents explained to them in a manner they can understand. A good many clients simply take it on faith that the preparer knew what they wanted, and that their documents carry out their intent.

Connie Stone, CFP,[®] ATP
Stepping Stone Financial Inc.
Chagrin Falls, Ohio

Planning for family members with special needs is not maximized at best, and mishandled at worst. This can lead to disastrous consequences for a disabled person.

Kendall Maddox, J.D., LL.M., CFP[®]
Maddox & Associates
Birmingham, Alabama

- Lack of self-proving affidavit.
- Revocable trust not funded or inadequately funded.
- Inadequate or nonexistent trustee powers.

