1 General Overview of Estate Planning and Estate Administration

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Differentiate between estate planning and estate administration
- Distinguish between short-term, mid-term, and long-term financial goals
- Discuss various types of estate planning strategies
- Analyze different types of life insurance policies
- Create an effective estate plan
- Discuss the functions of a personal representative
- Explain the standard of care required of a fiduciary
- Understand the role of a legal assistant in the estate administration process
- Differentiate between letters of administration and letters testamentary
- Create a family tree ticker

CHAPTER OVERVIEW

The purpose of this chapter is to provide a general overview and introduction to the concepts of estate planning and estate administration. For most people the word "estate" conjures up visions of mourners in black, bleak cemeteries, and sometimes, wicked stepparents who have control over all the family money. Few, if any, of these visions are true or accurate.

Estate planning is essentially a branch of financial planning. Its purpose is to help the individual acquire and accumulate assets so that all of his or her financial needs and desires during life can be met. The appropriate distribution of these assets on the person's death is merely one aspect of overall estate planning. Rather than being concerned with a person's demise, the estate planner is actually involved with a person's life. If a person has no assets, there is nothing to distribute after death. The estate planner attempts to help the client to have assets sufficiently substantial so that there is a need to plan the distribution of these assets on death.

Estate administration, on the other hand, concerns the distribution of a person's assets after death. One who administers an estate will be involved with passing title to property from the deceased to his or her heirs, according to the wishes of the decedent or the provisions of the state statutes; seeing that all taxes are paid; and insuring the orderly conclusion to the person's legal life. In other words, estate planning helps a person acquire assets during life, and estate administration helps distribute those assets upon the person's death.

This chapter will discuss the various approaches that can be used for the proper planning and administration of an estate, the courts and statutes that are involved in both the planning and administration of the estate, and the role of the legal assistant with respect to the foregoing.

Estate Planning

Estate planning can be defined as the method whereby a person accumulates, manages, and disposes of real and personal property during his life and after his death. The primary function of effective estate planning is to meet the short- and long-term financial needs of the client and to see that the client's particular concerns can be met after his death. Although all estate planning is concerned with the acquisition of property with the least possible negative tax consequences, each person's financial plan will of necessity be different because of each person's unique financial needs.

Lawyers and financial planners are involved in creating an estate. The financial planner, usually certified, is conversant with all types of potential investments that can provide either capital growth or income. In order to see that the investment objectives designed by the financial planner are

met, the attorney is involved in the preparation of all legal documents pertaining to these investments. In each case, the legal assistant aids in gathering the information necessary to create the estate plan.

The first questions to be answered with respect to estate planning are: What are the client's current assets? Family situation? Financial goals? In order to be effective and appropriate, the estate plan must take into consideration all of these factors.

If a client has few assets, the first objective is to devise a method whereby he or she can accumulate some property. This requires a detailed analysis of all of his or her income and expenses and a determination of how much of that income is disposable. **Disposable income** is that income a person has after paying all taxes and expenses for a given period (a week, a month, etc.). It is only this money that can be used to acquire assets; the rest of the income is being used to support his or her current life. If a person has no disposable income, it becomes necessary to create a budget so that some income, however little, can be saved. Conversely, if a person has a great deal of disposable income, it is necessary to see that the income is appropriately invested so as to meet the future financial needs of the client.

EXAMPLES:

1. Loretta Jones has a very modest salary. At the end of the month, after paying rent, utilities, food, tuition, and so forth, she has very little left as disposable income. Loretta needs to find out whether there is some way she could better manage her money so as to accumulate some savings.
2. Tom Poole spends very little of his actual income. At the end of the month he has several thousand dollars left. Tom needs to find appropriate investments for his disposable income to make it productive, that is, to produce more income or growth.

Each person's family situation helps determine his or her financial needs. The financial needs of a couple who is retired with grown children are entirely different from those of a single mother with a young child. Estate and financial planning is concerned with assuring that the financial needs of the client's family can be met: providing for the education of a young child, purchasing a first home for a young couple, and assuring a worry-free retirement.

Finally, the financial wishes of the client must be taken into consideration. It may be well to provide for needs, but most people would like to see their hard work result in more than just basic necessities. Vacations, buying a first or second home, purchasing a car or boat, and so on, are all worthwhile and psychologically necessary ingredients of each person's estate plan.

These financial dreams or desires can be grouped into short-term goals, mid-term goals, and long-range plans. A trip at the end of the year is a short-term goal; buying a first home within five years is a mid-term goal; and paying for a child's education is a long-term goal. All of these goals must be identified before an effective estate plan can be created.

EXAMPLE:

Oscar and Hyacinth want to buy a vacation home that they can also use for their retirement. They would like to buy the home when Byron graduates from college. This is a mid-term goal, because Byron is already at university and will probably complete his education in the next few years.

It is beyond the scope of this book to discuss in detail all of the potential investment strategies that are available. That would be more appropriate to a treatise directly concerned with finance and investment. However, several financial strategies that are of particular concern with respect to estate planning should be noted.

When a long-term strategy has been devised for the client, it is necessary to see that this plan can still go forward even if the client dies. This is why the family situation is important. Most peoples' financial plans involve persons other than themselves — spouses, children, other relations, and friends — and as a part of financial planning the professional must make sure that a person's financial wishes for others can continue even after his or her death.

This endpoint of financial planning — what to do on death — raises two problems: (1) keeping the person's assets intact without having them diminished by taxes, and (2) identifying the most effective method of insuring that the decedent's wishes are carried out with respect to transferring his or her property after death.

Many tax considerations are involved in planning an estate. The taxing authorities get involved during life (by taxing income and transfers of large amounts of property as gifts) and after death (by taxing the estate of a decedent). Good estate planning keeps the tax consequences to a minimum. Income taxation and state estate taxation are beyond the scope of this text, but a few words must be mentioned at this point with respect to federal estate and gift taxation. (A more detailed discussion appears where appropriate throughout the text and specifically in Chapters 3, 6, and 9.)

Only property that the decedent owns at the time of death is taxable (plus some property transferred within three years of death, under certain circumstances discussed in Chapter 8). This property is divided into two broad categories: **nonprobate assets,** which is property that passes directly from the decedent to another person without court authorization but by operation of law, and **probate assets,** which is property that must be

transferred by order of the court. Both nonprobate and probate assets may be taxed, but if the decedent's assets have been properly managed prior to death, the estate may be able to reduce its tax burden. Certain strategies can be employed, depending on the client's particular circumstances, to divest the client of some of his or her property during life.

EXAMPLE:

Five years before his death, Dr. Lear gives his home to his daughter Grace as a gift, even though he and Donna continue to reside in the home. On Kingston's death, because title belongs to Grace, the house is not part of Kingston's probate assets — he did not own the home when he died. However, his estate still may owe taxes on the value of the house. See Chapter 8.

Estate Planning Strategies

Gifts

The most common method whereby a person transfers property during life is as a **gift,** which is a transfer of property by a **donor** (giver) to **a donee** (recipient) without **consideration.** In other words, it is a transfer in which the donor gives, but does not receive, something of value. All property transferred by outright gift (in which the donor does not retain any interest) is owned by the donee and is not part of the donor's estate. However, the Internal Revenue Service imposes a tax on property transferred by gift. A donor may transfer, tax free, up to $13,000 worth of property per donee per year. Gifts above this amount, except for gifts to spouses, to charities, or for tuition or medical care, must be reported to the IRS on Form 709. No tax is due on these gifts until the total amount exceeds the maximum size of an estate that may pass tax free because of the Unified Tax Credit (Chapter 8). In 2001, the maximum amount that could pass estate tax free was $675,000. In 2002, the amount increased to $700,000; in 2004, $1.5 million; in 2006, it became $2 million; and in 2009, $3.5 million. In 2010, there will be no estate tax, but in 2011 the tax may revert back to the 2001 levels. In December of 2010, Congress extended the provisions of the Unified Tax Credit for two years, 2011 and 2012. The amount of the tax credit exemption for these two years is $5 million. Significantly, under these new provisions, a surviving spouse is entitled to use any portion of the $5 million exemption that his or her deceased spouse failed to use in addition to his or her own $5 million exemption. In other words, if the first spouse to pass away did not use any of the permissible credit, the surviving spouse may have a total tax credit of $10 million. When the donor dies, the gifts reported on Form 709 are deducted from the dollar

exemption permitted for the year of death. This tax exclusion means that a person may transfer much of his estate while he is alive and be able to see the recipients enjoy the property. (The amount of the gift exclusion is doubled if the gifts are made jointly by husbands and wives.) Many states impose a gift tax; for information regarding state taxation, see Chapter 9.

EXAMPLE:

When Kingston transferred title to the house to Grace, he paid a gift tax on the transfer. In this manner Grace received the house "tax free."

Title Transfers

Another strategy that can be employed to minimize estate taxation is to hold title to property in multiple ownership, such as a **tenancy by the entirety** or a **joint tenancy.** The specifics of these types of ownership will be discussed in detail in the next chapter, but for the moment its import is that, with certain types of multiple ownership, upon death the property passes immediately to the surviving owner. If certain legal steps are taken when title to the property is created, a portion of this property may be excluded from the client's taxable estate, and the surviving owner acquires the property immediately upon the client's death.

EXAMPLE:

Cornelia and her husband hold title to their house as tenants by the entirety. When her husband dies, as the surviving tenant, title to the house immediately passes to Cornelia. See Chapter 2.

Trusts

Establishing a trust has become a fairly common method of transferring property while alive so as to avoid estate taxation on death. Trusts will be fully discussed in Chapter 4, but for now be aware that, if properly drafted, a person can transfer his or her property while he or she is alive to a trust that is considered a separate legal entity, and so, upon death, the property is owned by the trust and not the decedent. Recently, the **living trust** (a trust established by a person that takes effect during his or her life) has become a popular strategy for estate planning. Be alert to the fact that creating a trust may have its own tax consequences, and, depending upon