Five Common Client Misconceptions about Estate Planning

Clarifying the Plan

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This article identifies five common client misconceptions about estate planning and suggests how to clarify a client's understanding about these issues.

Part of an estate planning attorney's role involves responding to deeply ingrained public misconceptions regarding the legal options available when a person dies. This article identifies five common client misconceptions and offers explanations in response to clarify these misconceptions. The key to helping clients understand the probate process is to communicate to them the analysis underlying the attorney's proposed probate plan.

Misconception 1: Avoid Probate at All Costs

Clients who believe it's best to avoid probate at all costs need to understand that having an estate pass by will is often less expensive and more efficient than relying on probate avoidance techniques. Colorado law provides for informal probate,[1] which is an administrative procedure rather than a judicial proceeding. Judges or magistrates do not become involved in an informal probate administration unless their involvement is requested by a party or later required. There are no mandatory hearings or court reviews of accountings and inventories, which can minimize the cost of estate administration. Instead, the court registrar typically processes a probate application and appoints the personal representative administratively without a court hearing.[2] The personal representative can then proceed to administer the estate free of court involvement.

The Colorado Probate Code structures estate administration by, for example, requiring the personal representative to publish notice to creditors and to prepare an inventory and accountings.[3] These important actions are often lacking in the transfer of assets by non-probate vehicles, which may cause costly disputes later on. Even with informal probate, the court has jurisdiction over the personal representative and is always available to address and resolve any difficult issues or conflicts that might arise during the course of the estate administration. Either the personal representative or an interested party, such as a devisee or heir, can involve the court. For example, a devisee or heir can take advantage of the court's jurisdiction by seeking court involvement if there is evidence that the personal representative is acting improperly, delaying administration, or otherwise breaching his or her fiduciary duties.

Another advantage of probate administration is that a single person can be placed in charge of the administration, while some probate avoidance techniques create situations in which multiple individuals are involved and must agree on the handling of the decedent's assets. This can result in chaos, uncertainty, disputes, income tax problems, and ultimately more costs than if one personal representative (who can be supervised by the court if necessary) were in charge of the estate administration.

Colorado also offers the useful tool of "Determination of Matters by Hearing Without Appearance" under Colorado Rule of Probate Procedure (CRPP) 24. Rule 24 replaced CRPP 8.8 (Non-Appearance Hearings) effective September 1, 2018.[4] By setting a matter in this fashion and delivering copies of the pleading, the proposed order, and notice of hearing without appearance to all interested parties, the personal representative or others can obtain court protection for past, present, or future actions or decisions related to the estate administration. The rule provides interested persons an opportunity to be heard by establishing a deadline by which written objections to the requested relief must be filed with the court. If the deadline passes without objection, the court can take action on the matter without the need to schedule a hearing with party appearances.

In the past, each judicial district and its judicial officers had different views on the appropriate scope of matters suitable for non-appearance hearings. This is because there is a delicate balance between due process protections and judicial economy when using this procedural tool. Former Rule 8.8 limited the use of the non-appearance hearing to "matters that are routine and are expected to be unopposed." Whether a matter met such standard was often subject to debate. But new Rule 24 eliminates that restriction and broadens the range of non-appearance hearings. Rule 24 should result in more efficient administration of probate cases because parties contemplating or threatening objections to estate administration decisions can now be (1) forced to commit on whether to initiate litigation within a compressed time period, and (2) required to state their position in a more expeditious fashion.

The hearing without appearance docket is a good example of how the Colorado Probate Code and CRPP streamline the probate process in Colorado: They provide a framework for probate administration while allowing the personal representative to be self-regulated, with interested parties bearing the responsibility for protecting their own rights and interests in the estate. The burden lies with the personal representatives and those they serve to be proactive and seek court involvement, but only if and when they believe it is warranted.

Another efficient Colorado probate process is the small estate affidavit, which can be used to collect probate assets where no real estate is involved and the net value of all probate assets is under a certain amount.[5] This allows estate successors to collect probate assets without any court involvement.

However, there are some situations where probate avoidance works best. Some states require significantly more court involvement and supervision of probate cases than Colorado. This can greatly increase the overall cost of estate administration and the time to complete it if the decedent owns real estate outside of Colorado. California is an example of a state with a more burdensome probate system. Practitioners must take care at the estate planning stage to identify whether a client's death will trigger a probate procedure in another state because the decedent owned real estate (including mineral interests) in that state. In such cases, it is important to consider probate avoidance techniques such as revocable trusts or business entities, including limited liability companies, to expedite the transfer of a decedent's out of state real property. Sometimes having a business entity hold only such real property is most efficient and can avoid the death taxes of the state where the real property is located.

Misconception 2: Give Assets to Children by Gift During Life to Avoid Probate

Some clients want to either add their children as joint owners to their home and other primary assets, or transfer full ownership to their children. But what might appear on the surface as an easy way to avoid probate can lead to headaches and expenses that the structured framework of a probate administration could avoid.

A major drawback of this approach is that it exposes the clients' assets to the children's creditors. Even if the children are financially responsible, unexpected events such as an "at fault" car accident can trigger financial instability. Or the parents' home or other assets could become entangled in a child's divorce.[6] The transfer of assets could also jeopardize the clients' ability to receive Medicaid in the future because such a transfer is considered a gift for penalty period purposes: There is a five-year look-back period for gifts, which can trigger a Medicaid ineligibility period.[7] Finally, even under the best of circumstances, having multiple children jointly own a residence increases the possibility of disputes regarding the management and sale of the property. It is dangerous to assume cooperation among children regarding real estate they jointly own and control. And if only one child is named as owner with the assumption that the child will share the property with the other children, there is a risk that such child will claim full ownership after the parents' death, resulting in costly litigation. This seems more likely if the child receiving title is also the parents' caregiver.

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Compounding these risks are the income tax disadvantages of adding joint owners to a client's home. If property is owned by a decedent at death, it generally receives an adjustment in basis to the value as of the date of death.[8] This adjustment can be very advantageous, especially for appreciated assets, such as a home that has been owned for many years. On the other hand, inter vivos transfers of the home by parents to children potentially deprive the property of a step-up in basis at death. Parents also jeopardize the use of the $250,000 home sale exclusion from capital gains by adding children as owners, if the children do not occupy the house as their primary residence and the home is sold during the parents' lifetime.[9]

Misconception 3: Use Beneficiary Deeds to Avoid Probate

Lay persons are frequently attracted to the use of beneficiary deeds, particularly if their only asset is their home. However, a multitude of complications relating to use of beneficiary deeds must be considered.

As with some other probate avoidance techniques, if multiple beneficiaries are named on a beneficiary deed, problems associated with joint ownership and control of real estate after death among uncooperative beneficiaries can arise. In contrast, a house that passes under a will can be more expeditiously managed and sold or distributed by a single individual acting as personal representative.

The client also risks creating title complications if the client does not include the names of the beneficiaries on the beneficiary deed.[10] A well-drafted will, on the other hand, can provide more flexibility in naming beneficiaries of the home, taking into consideration changed circumstances after the will's execution. Also, a will can use more general designations such as "all my children" or "all my issue," avoiding the need to specifically name the beneficiaries.

Some title companies will not insure title to real estate passing by beneficiary deed for the first four months following the owner's death, because there is a statutory four-month period during which third party interests in the property can be asserted by recording such interests with the county.[11] Real estate passing under a will is not exposed to the same period of title uncertainty, although creditor claims can still be asserted against an estate for up to one year after death.

Another drawback to the beneficiary deed is that it can convert the property from an exempt asset into a countable resource for Medicaid eligibility purposes.[12] If an extended stay in a nursing home becomes necessary for a client with a beneficiary deed, a court proceeding to revoke the deed may be the only solution to gaining eligibility, if the owner no longer has capacity to do so himself or herself. A beneficiary deed cannot be cancelled or revoked by the grantor's will. Further, to reverse the transaction, the revocation document must be recorded with the appropriate county before the grantor dies.[13]

Misconception 4: "Convenience" Accounts are a Good Plan for Incapacity

Many clients assume that adding their children to their checking and savings accounts as joint owners is necessary and appropriate to provide for the clients' incapacity. They assume that, as joint owners, the children can pay their parents' bills when the parents begin struggling to manage their own financial affairs. These "convenience" accounts are neither necessary nor advisable. They expose the parents' cash assets not only to the children's creditors and to the marital rights of children's spouses, but also to the risk that a child will unilaterally use the accounts for the child's own benefit.

This risk is not necessarily avoided by adding to the accounts only the "responsible" child who lives nearby. That child might decide after the parents' deaths to keep the accounts to the exclusion of the siblings. Children sometimes consider such joint accounts to be "compensation" for the caregiving assistance they provided to the parents during the parents' mental or physical decline before death. The other siblings frequently dispute such claims and take the position that such "compensation" is excessive and the accounts with the caregiving child should be shared with them. This can result in expensive and emotionally charged litigation with claims of undue influence, lack of capacity, imposition of constructive or resulting trusts, and other causes of action and remedies. Such attempts to recover the disputed accounts can take a heavy toll on family relationships.

A well-drafted financial power of attorney, or even a bank power of attorney signature card, is usually a much better device for dealing with financial management in the event of incapacity. With both devices, ownership of the accounts remains with the parents. Post-death, the personal representative can control and access the accounts and is charged with distributing the funds pursuant to the parents' wills, avoiding the potential pitfalls of so-called "convenience" accounts.

Misconception 5: A Revocable Trust is Better than a Will

Many clients think a revocable trust should be the primary estate planning document. While often appropriate for the client's circumstances, revocable trusts can also create unnecessary complications in estate planning. They are often more expensive and difficult to set up and maintain than wills, primarily because they require assets to be titled in the name of the trustee or trust. Revocable trusts must address what happens not only at death, but also during lifetime. Using a professional trustee may result in the need for that trustee's approval of the trust's terms in the drafting process. A professional trustee may also require that substitute corporate boilerplate language or other additional provisions, such as specific language addressing fiduciary compensation, be included.

On the other hand, where a power of attorney to a trusted individual is not a viable option, a trust naming a professional fiduciary is the best option. Clients sometimes incorrectly assume that titles to all their assets are automatically transferred to the trusts after the execution of the trust instruments. A general bill of sale can be used to transfer tangible personal property, but is ineffective as to other assets such as financial accounts and real property, which must be specifically retitled. Even if an attorney initially assists with re-titling assets, clients often acquire different assets during their lifetimes but fail to remember to title them in their trusts. This often leads to the need for probate administration to transfer those assets not titled in the trust if the use of a small estate affidavit is foreclosed.

Further, clients often do not realize that a trust administration following a settlor's death can be as expensive and complicated as an administration of a testator's probate estate. Trust administration requires time and incurs expenses for the trustee to establish the trustee's rights as successor trustee, to collect and distribute trust assets to the trust's beneficiaries, to pay taxes and debts, and to otherwise wind up a decedent's affairs. Assets held in or transferred to a decedent's revocable trust at death typically have no greater creditor protections than assets passing as part of a probate estate pursuant to a will.[14] Also, trustees, like personal representatives, are entitled to reasonable compensation for work performed in their fiduciary capacity and for legal assistance, which they should obtain. And transferring non-probate assets to the trust at death, such as life insurance proceeds, can needlessly expose them to the creditors' claims.

Where appropriate, well-drafted wills can provide for testamentary trusts to be set up that are either mandatory or discretionary, based on the clients' specific wishes and family circumstances, and that provide estate tax avoidance at the surviving spouse's death. Such trusts can be potentially useful in second marriage situations to provide for the surviving spouse while also preserving remaining assets for the decedent's children.

A common misconception is that establishing a trust is necessary to reduce death taxes. The 2018 Tax Cuts and Jobs Act[15] effectively doubled the federal lifetime exemption amount to approximately $11 million (or $22 million for married couples) until at least 2025. During this time frame, unless an individual's estate exceeds $11 million or a couple's estate exceeds $22 million, no federal estate taxes will be owed, regardless of whether a revocable trust or a will was used. Further, with the available use of portability made permanent in 2013 under the American Taxpayer Relief Act,[16] any unused federal estate tax exemption of the first spouse to die can be preserved by the surviving spouse through a timely filed federal estate tax return. This accomplishes the same tax objectives without the complexity of establishing lifetime trusts for spouses and may be a better option than placing the assets of the first spouse to die into a family or bypass ("B") trust, with a resulting loss in stepped up basis at the surviving spouse's death.

Conclusion

Estate planning is more of an art than a science. When analyzing which documents and devices to use, attorneys must consider the client's specific needs and assets, and carefully weigh the benefits and risks of each approach.

Clients often enter the estate planning process with preconceived notions and lack understanding of the complexity, cost, and disadvantages of the type of planning they think is best for them. It is the practitioner's role to help them select the appropriate planning approach. Practitioners can expedite this process by correcting misconceptions, providing accurate and practical information and recommendations, and painting a complete picture of the estate planning and administration process. CL


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NOTES

1. CRS §§ 15-12-301 et seq.
2. *Id.*
3. CRS §§ 15-12-706 and -1003.
4. Changes to Rule 8.8, along with the other probate rules, were recently recommended by the Colorado Supreme Court Advisory Committee on Rules of Probate Procedure. The Colorado Supreme Court adopted them, and they became effective on September 1, 2018. The revamping of the probate rules has been a long process; the project started a number of years ago through the efforts of the CBA's Rules and Forms Committee and the Probate Advisory Committee at the Colorado State Court Administrator's Office. *See* Leith and Johnson, "Overview of the Revised and Reenacted Colorado Rules of Probate Procedure," 47 *Colorado Lawyer* 60 (Nov. 2018).
5. CRS § 15-12-1201. The affidavit can be used for a 2018 decedent if the probate estate does not consist of real property and the net value of the probate estate is under $66,000.
6. The probability of divorce is quite high. The Centers for Disease Control and Prevention estimated a 2016 marriage rate of 6.9 per 1,000 total population and a 2016 divorce rate of 3.2 per 1,000 total population. www.cdc.gov/nchs/data/dvs/national_marriage_divorce_rates_00-16.pdf.
7. *See* www.medicaid.gov/medicaid/eligibility.
8. 26 USC § 1014.
9. According to IRS Topic No. 701, to qualify for the exclusion from capital gain, the taxpayer generally must have owned and used the home as his or her main home for a period "aggregating at least two years out of the five years prior to its date of sale," www.irs.gov/taxtopics/tc701.
10. CRS § 15-15-401(3). *See* Lemke, "Practical Considerations in the Use of Colorado Beneficiary Deeds," 44 *Colorado Lawyer* 41, 42–43 (Jan. 2015); Stevens and Benjamin, "Beneficiary Deeds in Colorado—Part 1: Overview of Legislation," 34 *Colorado Lawyer* 79 (June 2005); Stevens and Benjamin, "Beneficiary Deeds in Colorado—Part II: Practical Applications," 34 *Colorado Lawyer* 103 (June 2005).
11. CRS § 15-15-407.
12. CRS § 15-15-403.
13. CRS § 15-15-405.
14. CRS § 15-15-103.
15. An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. 115-97, 131 Stat. 2054.
16. American Taxpayer Relief Act of 2012, Pub.L. 112-240, 126 Stat. 2313.