PUBLICATION

Does Your Estate Plan Still Fit Your Estate?

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Often, once the will has been signed it is stuffed away in a desk, filing cabinet or safety deposit box only to be forgotten. Most people consider their wills to be their estate plans, but a proper estate plan is a comprehensive plan that ensures your property and health care wishes are honored at your death or incapacity. At a minimum, a proper estate plan includes your will, a durable power of attorney and an advance directive for health care. It may also include revocable trusts (or living trusts), special needs trusts or irrevocable life insurance trusts. Your estate plan should be viewed as a working program that must be revisited and updated as your situation in life changes.

If it's been more than a few years since you reviewed your estate plan, you may be shocked to discover that the documents which look fine on their face no longer accomplish your estate planning goals. This result can occur because of intervening changes in (a) federal estate tax or state specific laws, (b) the value and ownership of your assets, (c) your family situation or (d) any combination of those factors. Consider the following scenarios.

If you are married and you and your spouse have wills or revocable ("living") trusts that were written when the estate tax exemption was much lower (perhaps under $1 million per person), such documents may mandate the creation of a trust at the first death. This trust would contain assets from the first estate in an amount equal to the then current tax exemption. The balance of the assets might pass to the surviving spouse or to a trust for the spouse's benefit. With the tax exemption at its current level ($5 million per person), all of a couple's combined assets may be protected from tax at the second death. If so, you might want to eliminate the mandatory trust, giving the surviving spouse the option to create a trust at the first death only if it is needed. The decision to have a trust or not could be made based on future law changes or other circumstances existing at the first death.

To complicate this scenario, consider that a mandatory trust equal to the current exemption may include all the assets passing at the first death. What if that mandatory trust does not benefit the surviving spouse? Such a trust may have been designed to benefit children from a former marriage or grandchildren (taking advantage of the exemption from "generation skipping transfer tax"). When the documents were drafted, such a trust may have comprised a much smaller percentage of the estate. Now the potential result is that the spouse could inherit very little.

Trusts for children can also be affected by change. Children who were very young when parents' estate planning documents were written may now have different needs than originally expected by their parents. Perhaps the children have prospered to the extent that they would like their parents to do some estate tax planning for them by leaving their inheritance, or some part of it, in trusts that will last for their lifetimes and ultimately pass to their own children. A child's need to receive benefits from a trust rather than an outright inheritance may also exist for other reasons entirely – parents may want to protect children from the consequences of financial setbacks or the claims of potential creditors, such as former spouses.

Some beneficiaries may have special needs that entitle them to government benefits. But the outright receipt of an inheritance or a required distribution from a trust can cause disqualification for those benefits. At the same time, the inheritance may not be enough to support the beneficiary for an entire lifetime. A special needs beneficiary can continue to receive government assistance while also receiving certain limited benefits from a trust created by a third person (such as a parent). Such a trust can supplement the available assistance and pay for "extras" that the beneficiary could not otherwise enjoy.

Perhaps in addition to wills or revocable trusts, you (or another family member) also created an irrevocable trust. Like any other part of the plan, these trusts can be affected by change. For example, a trust designed to own life insurance so as to keep the insurance proceeds out of the taxable estate of the insured may no longer be necessary due to the larger tax exemption; a trust designed to hold and manage a specific asset may make no sense if that asset has been sold or if other plans for it are now more appropriate. The needed changes may be something quite simple, such as where a person named as successor trustee is no longer a suitable choice and should be replaced. If your State has adopted the Uniform Trust Code (UTC), it is now possible in many cases to modify or even terminate otherwise irrevocable trusts. Doing so can simplify the estate plan, add needed flexibility, or make the trust's terms fit better with current circumstances.

Even if the terms of your estate planning documents are still suitable, changes in asset ownership and beneficiary designations may keep them from working as intended, or even make them meaningless. Through the years, a person may have changed the title on individually owned assets into joint names. If a married couple owns everything jointly, they may have no assets to fund a trust at the first death. A person who has tried to allocate assets equally among children by adding their names as owners may discover that based on that form of ownership alone, some children would be shortchanged. The same result can occur with the "transfer on death" (TOD) designations available for brokerage accounts, mutual funds, etc. Promoted as a way to 'avoid probate,' these TOD designations create havoc when the terms of the account owner's will or trust do not exactly match the TOD designation.

These examples above describe just a few of the detrimental results that may occur when circumstances change but estate plans do not. A larger estate tax exemption may mean that many people no longer need to consider the impact of federal estate taxes. But that exemption does not eliminate the main reason people have always planned their estates: to see that their assets end up in the hands of, or will be managed for, their intended beneficiaries. Don't yield to the temptation to ignore the non-tax factors which must be periodically reviewed and updated. Instead, make sure that your estate plan still fits your estate!

One final note concerning federal taxes. The campaign in D.C. to reduce our national deficit will put significant pressures on Congress to find additional revenues, and such pressures could very well result in a reduction after December 31, 2012 (hopefully not before) of the $5 million exemption amount currently in place for estate, gift and generation skipping taxes. See our April 14, 2011 Tax Alert.

Should you wish to discuss with us any aspect of your particular estate plan, whether because of non-tax or tax reasons, please contact any attorney in the firm's Tax Department.