ESTATE PLANNING - AVOIDING PROBATE

by Samuel D. Swisher, JD, CFP®
Relationship Manager
Planning Advantage Services

and Rodney Piercey, JD
Pluymert, Piercey, MacDonald & Amato
Hoffman Estates, IL

Avoiding probate should be a key element of any estate plan. Without good planning, your estate will be subject to probate in your home state and any other state where you own real estate or other substantial property.

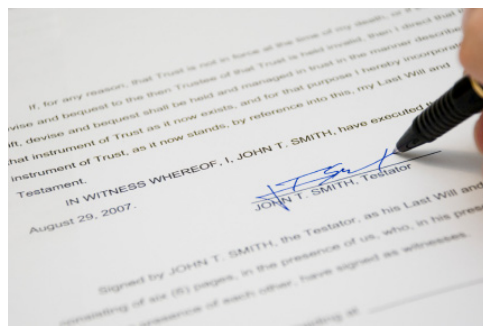
WHAT IS THE PROBATE COURT SYSTEM?

Probate courts were established in the early 1900's at the urging of banks and other creditor institutions in an effort to secure assets of the decedent to repay debts outstanding at death. In general assets over a certain threshold (in Illinois over $100,000, in Texas over $50,000 excluding Homestead and Exempt Property) that do not pass by automatic transfer upon death must pass through the probate court system. Examples of automatic transfers are joint tenancy, beneficiary designations, transfer on death accounts, etc. Only after this lengthy and expensive process of finding all of the decedent's creditors and satisfying the outstanding debts will the heirs receive their inheritances.

WHY AVOID PROBATE?

Below is a discussion of Illinois Probate issues which are similar in most other states

- Creditors get first shot. Because the Probate Act is designed to protect creditors, the court will pay all creditors before loved ones get their share of probated assets. Therefore, if you were to die in an auto accident that was your fault and did not have sufficient liability insurance, creditors could take the entire probated estate away from your loved ones.
- Delay. Your estate is required to run a legal notice of your death in the newspaper to start the claims process. Potential creditors have six months after that to start the claims process. A Probate court case is rarely completed in less than eight months, and usually takes a year, but will take two years if the estate is in excess of the federal estate tax free amount, currently $2 million (scheduled to decrease to $1 million in 2011 unless Congress passes new legislation).
- Cost. Probate rarely costs less than $4,000 in legal fees. Executor's fees generally cost the estate 1% to 3% per year, but could drain as much as 8% in legal fees from the estate if creditors are making claims or heirs are squabbling.
- Publicity. Probate is public. Anyone can ask to see the entire contents of the probate court file, including asset values (which may have been conservatively calculated). As mentioned earlier, your Executor must run a legal notice of your death in the newspaper for three successive weeks to give notice to the world that a Probate Court case has been opened. In addition, each known creditor must be sent an individual notice in writing.



- Uncertainty. Probate Court offers an opportunity for disgruntled heirs, the in-laws, and out-laws to make claims. Because they get first shot and because disgruntled heirs are encouraged to raise disputes in court, loved ones should not plan to use funds from the estate until the claims period (6 months) is over.
- Multi-state Probates. Each state has a Probate Act. Most allow a small estate to pass without a Probate Court case. Therefore, if you have property in your name alone at death in other states, a probate case would likely be opened in each state.
- Stress. While still grieving the loss of a loved one, heirs have the additional stress of dealing with lawyers, courts, juries, and judges over the one - two year Probate period.

How to Avoid Probate?

There are six ways to avoid probate.

- Joint Tenancy. Owning property as joint tenants will postpone probate until the death of the last person. Appreciating property (like real estate, stocks or bonds) that is jointly owned will receive only a partial step up in basis at the death of a joint tenant
- Pay on Death Accounts (aka Transfer On Death Accounts). This is one method of transferring bank accounts to heirs without probate. However, it does not offer flexibility. For instances, installment payments to heirs would not be possible.
- Life Insurance or Retirement Plan Beneficiaries. Naming beneficiaries under an insurance contract or retirement plan avoids probate. However generally beneficiary designations on life insurance lack flexibility to distribute proceeds
- Land Trusts. Use of a land trust will avoid probate for real estate. Despite set up costs and annual trustee fees this is a useful technique in the right circumstances.
- Making Gifts. Making annual gifts to loved ones will avoid probate and will not trigger gift tax if less than $12,000/year per recipient. However the recipient's tax basis is the same as the donor's. If the asset is passed at death the tax basis is stepped up to fair market value.
- Revocable Living Trusts. Revocable Living Trusts work for all types of assets, for all ages of loved ones, and in all 50 states. The only costs are in the first year to create, which are generally about $1,000-$2,000 more than a plan that uses only a Will.

What is a Revocable Living Trust?

A Revocable Living Trust is a separate legal entity that can own assets. It remains in existence even after the death of the person who set it up. While the person is alive, he/she can change the terms, terminate it, and act in the same manner as if he/she owned the assets outright. The important difference is that upon death assets in the trust are distributed according to the trust terms (not the Will) and the assets do not go through the probate process.

Advantages of a Revocable Living Trust

- Probate Avoidance. All assets which are in a trust at death avoid most of the disadvantages of probate, including delays in accessing funds, costs, priority creditor claims, etc.
- Creditor Protection After Death. If the terms of the trust are properly drafted, liabilities of the decedent cannot be satisfied from trust assets. For example, if the decedent caused a death that was his fault in a fatal auto accident, none of the trust assets could be seized by his creditors.
- Access to Assets. All assets in a trust at death or disability are immediately available to the successor trustee.
- Privacy. A trust is a private document confidentially disclosed on a need-to-know basis.
- Guardianship Proceeding Avoidance. Assets in a trust will not be subject to a guardianship proceeding if you become incapacitated. Instead the terms of your trust will provide automatically for a new trustee to take over the management of your assets.

How are Revocable Trusts Used in Estate Plans?

Revocable Living Trusts are arguably the most powerful documents used in many estate plans. Typically each spouse creates his/her own Revocable Living Trust and a short Will passing the small residue of their assets at death to the trust. Revocable Living Trusts not only offer avoidance of probate and creditor protection at death, but also provide for management of the assets while the kids are still young, and estate tax advantages by "balancing" the spouse's estates to allow each the maximum estate tax exemption (currently $2,000,000 each)..

Please contact your Relationship Manager if you would like to discuss your estate issues or if you would like the name of an estate planning attorney.

This article does not constitute legal advice. Each person should consult with legal counsel before implementing any estate plan.