To Avoid or Not to Avoid Probate

1. **Probate**

   a. Advantages:

      (1) Probate court supervision of administration.
      (2) Protection of:
         (a) Testator's heirs
         (b) Testator's creditors
         (c) Federal and state taxing authorities

   b. Disadvantages:

      (1) Fees and expenses (attorney and executor fees)
      (2) Delays in distribution and lack of availability of assets to heirs
      (3) Allegations that losses and excess expense result
      (4) Inconvenience of dealing with the court and bureaucracy

2. **Procedures Available to avoid probate**

   a. Joint tenancy
   b. Totten trusts
   c. Private annuities
   d. Antenuptial agreement
   e. Postnuptial agreement
   f. Employee benefit plans
   g. Life insurance
   h. Powers of appointment
   i. Power to withdraw
   j. Community property left outright to spouse
   k. Series E bonds
   l. Stock brokerage accounts
   m. Revocable trusts
   n. Irrevocable trusts
   o. Uniform Gift to Minors Act

3. **Joint Tenancy**

   a. Use for following assets:
      (1) Bank accounts
      (2) Savings accounts
      (3) Securities (stocks and bonds)
      (4) Residence or other real estate (joint tenancy between spouses)

      CAVEAT: Same effect accomplished with community property under Probate Code Sections 6401 and 13500. Joint tenancy has limited use because of practical problems, and tax disadvantages.

   b. Advantages:

      (1) Simple for survivor to have property transferred.
      (2) Creditors of deceased joint tenant generally have no claim against deceased joint tenant's

interest.

(3) Useful if asset will decline in value when owned by husband and wife. Survivor's one-half does not get reduced basis on valuation date.

c. Disadvantages:

(1) Inflexibility. Joint tenant's rights are determined immediately on signing of instrument. No modification without consent of all joint tenants.

(2) Independence of new joint tenant is instantaneous. Joint tenant has vested right to sell, mortgage, partition, donate, or transfer joint tenancy interest without consent of donor joint tenant. This destroys the joint tenancy.

(3) Incompetence of joint tenant may require conservatorship (inconvenience in sale, transfer, or hypothecation).

(4) Arguments about management or decision to sell must be resolved by litigation.

(5) Will has no effect on the joint tenancy property.

d. Tax consequences:

(1) Between spouses, no present gift on creation of joint tenancy from assets of one spouse.

(2) Joint bank accounts and U.S. savings bonds. On creation of joint tenancy, no gift until noncontributing joint tenant withdraws money or cashes bonds.

(3) On death of first joint tenant, only decedent's one-half gets step-up basis for federal income tax purposes.

CAVEAT: If all property is put into joint tenancy for purpose of avoiding probate, attorney should have a will signed to prevent intestacy on unforeseen acquisitions of property and termination of joint tenancies.

4. **Totten trusts**

a. Definitions: A savings or bank account with depositor (trustor) naming himself as "Trustee for the benefit of ______________________________."

CAVEAT: Many individual establish such trustee accounts on the advice of others that this kind of trustee account enables the depositor to get additional federal savings account insurance not otherwise available. The attorney must warn the client about the dangers of these Totten trust accounts, which may frustrate the client's dispositive wishes, permitting the money in the account to go to an unintended donee. (If a true Totten trust, use social security number of grantor.)

b. Depositor owns the account. Beneficiary has no rights while depositor is alive, but receives the money on death of depositor.

c. Tax effects:

(1) Federal estate tax: taxed to depositor.

(2) Gift tax: none

(3) Income tax: income is taxed to the depositor unless the trust is not a Totten trust but one in which the beneficiary has a true equitable interest and is entitled to the income.

d. Useful in a small estate to avoid probate, or in an estate consisting entirely of bank accounts.

5. **Private annuities**

a. Ordinarily, among family members only.

b. Risky for economic and tax reasons.

c. Requires sophisticated legal draftsmanship and evaluation.

6. **Antenuptial and postnuptial agreements**

   a. Appropriate in second and third marriages to protect heirs of prior marriages.
   b. For older clients.
   c. Problems of record keeping to avoid commingling community property and separate property.
   d. Drafting and disclosure - sensitive emotional problems.
   e. Transfers of property in premortem settlement may create gift and estate tax consequences (present interest gift).

7. **Employee benefits - the forgotten asset**

   a. Social security
   b. Deferred compensation plans
   c. Life insurance
   d. Qualified profit-sharing plan (watch lump-sum distribution)
   e. Qualified pension plan (watch lump-sum distribution)
   f. Qualified stock bonus plan
   g. KEOGH plan (HR 10) and Individual Retirement Plan (IRA)
   h. Gift to heirs of employee

8. **Life insurance**

   a. Use: liquidity, pay estate taxes, and existence of estate
   b. Abuse: excess premiums and coverage of impoverished client
   c. Problems in transfer to wife of community or husband-owned policy
      (1) Subsequent marital dissolution--husband not insurable
      (2) Failure to pay premiums from wife's separate bank account (but not if wife is beneficiary)
      (3) On predecease of wife, ownership of policy reverts to husband unless wife's will provides otherwise, i.e., to children or trust
      (4) Gift within three years of death includable in husband's estate

9. **Power of appointment**

   a. General power: includable in estate of holder
   b. Special power: not includable in estate of holder for federal estate taxation
   c. Hidden power: includable in estate of holder although not recognized as a general power of appointment
   d. Examples of hidden powers:
      (1) Power to invade a trust, not limited by an ascertainable standard; "health, support, maintenance, and education."
      (2) Power to pay estate taxes or any other taxes, debts, or charges in favor of a donee's estate, to pay support for dependents, to end trusts, uncontrolled discretion, ignore fair treatment of beneficiaries, to remove trustee, to borrow without adequate security.

10. **Power of withdrawal**. Often used in place of automatic distribution to beneficiary of trust. Under these circumstances, the beneficiary may not wish to or may be unable to exercise the power for various reasons, including:

    a. Experiencing marital difficulties
    b. Imprudent business person
    c. Incompetent physically or mentally
    d. Unknown whereabouts of beneficiary
    e. Desire that trust provisions continue

11. **Trusts** (revocable and irrevocable)

a. Advantages:

(1) Reduces probate and administration costs
(2) Test of trust management during trustor's lifetime (revocable trust)
(3) Assets usually more rapidly available to beneficiaries
(4) Revocable trusts can be used to reduce estate taxes
(5) May avoid conservatorship for assets of aged client
(6) Reduces legal contest on dispositive provisions
(7) Eliminates public nature of probate proceedings
(8) Court supervision available for disputes and instruction to trustee

b. Disadvantages:
(1) Record-keeping requirements and expense if trust is funded
(2) Tax filings if trust is funded and has income
(3) Expense of trustee if trustee is an institution or professional trustee
(4) Asset segregation and avoidance of commingling
(5) Costs of establishing the trust (legal fees)

c. Dangers of irrevocable trusts for living persons:
(1) Change in circumstances
(2) Unforeseeable events (economic, family, marital)

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