

Chapter 2

TRANSFERRING PROPERTY WITHOUT A WILL

A Cautionary Tale

Darren and Samantha are newlyweds, each of whom has grown children from a previous marriage. They decide to buy a house together and take title to the house in **joint tenancy with right of survivorship** making them co-owners.

After unpacking the last boxes, the happy couple decide to complete the remaking of their lives and rewrite their wills. Both of them want their assets to go to their own children from their first marriages. So each writes a basic will that leaves everything to his or her own children. Samantha's daughter, Tabitha, who is living in a tiny apartment with her husband and kids, will get Darren and Samantha's house when Samantha dies; Darren's children, who have nice homes already, will get the rest of the couple's assets. And a few years later, Samantha dies, content because she believes she has provided for her daughter and her family.

Samantha will never know that her estate plan failed to accomplish the one thing she wanted most: giving her house to her daughter. She didn't realize that the joint tenancy she and Darren created meant that ownership of the entire house passed to Darren at the moment of her death, regardless of what her will said. She never knew that Darren was later beset by several costly illnesses and had to sell the house. His children--not hers--received what was left when Darren died two years later. A **prenuptial agreement** (a signed contract between Darren and Samantha) would have prevented this, as would holding the house in another form of tenancy.

A WILL ISN'T ENOUGH

Unfortunately, this situation is familiar to many estate lawyers. Too many people don't understand that there's more to estate planning than writing a will.

A will is usually the most important document in planning your estate, but it doesn't cover everything. In the **community property** states (see the community property section of this chapter), your will can only control half of most marital assets. Other benefits not controlled by a will or trust include IRAs, insurance policies, income savings plans, retirement plans, and joint tenancy (some jurisdictions also have a special form of joint tenancy for married couples called **tenancy by the entirety**). A good estate plan must coordinate them with your will and trust. Using them well can give your beneficiaries money much more efficiently than a will can. Use them badly, like Samantha, and you can negate your estate plan and frustrate your wishes.

Let's look briefly at the other ways you can transfer property.

Retirement benefits and annuities: beyond the gold watch

Most of us are entitled to retirement benefits from an employer. Typically, a retirement plan will pay benefits to beneficiaries if you die before reaching retirement age. After retirement, you can usually pick an option that will continue payments to a beneficiary after your death.

In most cases, the law requires that some portion of these retirement benefits be paid to your spouse. These may be rejected only with your spouse's properly witnessed, signed consent. (These accounts are subject to the payment of the income tax that has been deferred during their existence. Sometimes a spouse rejects benefits because of tax consequences or because there is enough income from other sources and the money might be better used by another beneficiary; check your plan to see

what is required for this waiver.) Payment options are treated differently for tax purposes. Ask your tax advisor how they'll affect your estate and tax planning.

IRAs (Individual Retirement Accounts) provide a ready means of cash when one spouse dies. If your spouse is named as the beneficiary, the proceeds will immediately become her property when you die. Like retirement benefits (and unlike assets inherited via a will), they will pass without having to go through probate.

Life insurance

Life insurance is often a good estate-planning tool, because you pay relatively little up front, and your beneficiaries get much more when you die. When you name beneficiaries other than your estate, the money passes to them directly, without probate. If most of your money is tied up in non-liquid assets like your company or real estate, life insurance gets cash into your beneficiaries' hands without their having to resort to a fire sale of other assets. Though procedures vary by company, usually the beneficiaries receive their insurance proceeds promptly. Generally, the beneficiary informs the company in writing of the death, sends a copy of the death certificate, and receives a check, often within a few weeks.

In general, the older you are, the less your family needs large amounts of life insurance. To decide how much to purchase, begin by estimating the long- and short-term needs of your survivors. Next, estimate what will be covered by other sources such as savings, a pension and other benefits. You'll want to buy enough life insurance to cover the difference.

Term insurance provides protection not for your entire life, but only for a specified term of years; it's cheap when you're young, but gets more expensive as you grow older. It can be a good idea, especially if you're relatively young or are starting a business venture; banks sometimes insist that an entrepreneur's life be covered by such a policy as a condition of advancing capital.

Here are some examples of the long- and short-term needs your family may encounter. To really help minimize their worries, write up a plan with categories like these. Then, when the insurance proceeds are paid, your survivors will know exactly how to budget the money they'll be receiving.

- **Costs of death.** Funeral, burial, and hospital bills ... these are the most common expenses that result from death. Life insurance proceeds reach your survivors quickly and are useful for dealing with these expenses. Your family should expect to pay \$3,000 to \$5,000 to cover such costs, more if the estate is complicated or medical costs were high and not covered by insurance. See chapter eleven for more information on such expenses.
- **Replacing lost income .** You don't want your family to have to sell property to support itself in the absence of your paycheck. Nor do you want your working spouse to have to take a second job. Experts say a family needs 75% of its former after-tax income to maintain its standard of living after the principal wage earner dies.

If you don't want your surviving spouse to have to work while raising the children, figure out how much it will take to support the family until the children are grown or at least able to care for themselves after school.

- **Grief fund.** Life insurance proceeds can support your family during the period of grief after your death so they don't have to go back to work too soon. This fund could equal up to several months of their normal income.
- **Educational expenses.** You can use life insurance proceeds (especially if paid into a trust) to set up a college fund for your children.
- **Mortgage-canceling life insurance.** Such a plan will pay off your mortgage when you die, so your survivors don't have to sell the family house. Or you can increase your life insurance by an

amount sufficient to pay off the mortgage.

- **Emergency fund.** After figuring out the other needs, you might tack on two or three thousand dollars to help the family cope with unexpected emergencies.

Three ways to pay

If you own life insurance on your own life, you can have the proceeds distributed in three ways.

1. To beneficiaries. The company pays the proceeds directly to one or more beneficiaries named in your policy. This is the quickest way to get the money to your survivors, and the proceeds pass free of income tax and can't usually be touched by creditors. However, they may be liable for estate taxes if the proceeds, when added to the other assets in the estate, total more than \$1 million (see chapter eight).

2. To your probate estate. If you choose this route, the proceeds will be distributed along with your other assets according to the terms of your will. (If you die without a will, your state's intestate succession laws will determine where the proceeds go.) However, they will be tied up in the probate process, will add to the cost of probate by making the estate larger, and will be subject to creditors' claims. You should do this only if your estate won't otherwise have enough money to pay debts and taxes.

3. To a trust. If you make the proceeds payable to a trust--either one set up in your will or during your lifetime--they will be distributed like the other trust assets. Paying the proceeds to a **life insurance trust** has several advantages:

- In many jurisdictions, creditors can't get at them.
- You will not have to pay estate tax on the proceeds if the policy was owned by the trust more than

three years before your death and the trust is properly set up.

- If the trust is for the benefit of your minor children, you can avoid the expense and court involvement of having a guardian manage this property. By having the proceeds paid to a trust, the trustee will have control over it.

Who should own the policy? If it's in your name, the proceeds payable on death (not the value of the premiums paid) will be included in your estate for estate tax purposes. That might force you to pay estate taxes if it pushes you beyond the \$1 million limit. If the beneficiary is your spouse, the **martial deduction** (see chapter eight) will enable your estate to escape taxes on the value of the policy. If someone else owns it (commonly, a life insurance trust), the proceeds aren't included in you estate, enabling you to reduce its taxable value. In any case, the recipient won't have to pay income taxes on the proceeds.

Life estates

You can, of course, give property to beneficiaries before you die, subject to gift taxes. Or you can sell it to a family member. Often it makes sense to get an appreciated asset (such as a house that's increased in value over the years) out of your estate to save on taxes; see chapter eight.

Life estates are different from gifts. Many older people choose to assign the family home to the children who have expressed an interest in living there after the parents have died. The parents retain what's called a "life estate" interest in the house, meaning the parents have the right to live there until they die and the property remains in their estate and is still taxable.

You can also choose to leave your children a life estate in family property that you want maintained down through the generations, like a home or china or other heirlooms. The children can live

in the house or rent it out during their lifetimes, but must maintain it in good condition for the ultimate beneficiaries, usually the grandchildren.

If this sounds like a move appropriate for your family, talk to your lawyer about such an assignment. Conveying property through a life estate gives up control of your property, and life estates are subject to complex legal rules and often cause more complications than they're worth.

Community property

The laws of Puerto Rico and ten states—Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin—provide that most property acquired during the marriage by either spouse is held equally by husband and wife as **community property**. (The major exceptions are property acquired by inheritance or gift.) When one spouse dies, his or her half of the community property passes either by will or intestacy. The other half of the community property belongs to the surviving spouse.

Unlike joint tenancy, community property isn't automatically transferred to the surviving spouse. When your spouse dies, you own only your share of the community property, and your spouse must give his or her share to you (or anyone else) in a will. Often the dead spouse's share must be probated, but it depends on what state you live in. California, for example, no longer requires probate for property passing directly from one spouse to the other.

This arrangement can affect your estate planning in many ways. What if your spouse assumes his or her life insurance will give you enough money and leaves everything to your grown children? In a community property state, that means half of the community property goes to the children. They now own half the house, half the car, half the vacation house on the lake. If there wasn't much cash in the estate or in insurance paid to them, the only way they can really benefit from the will is to sell the

property so they can share the proceeds. You'll either have to move out and get another car, or they'll have to struggle along until you die. Married people in community property states should think long and hard before leaving property to anyone other than their spouse.

Community property laws affect how much of your family's property you can legally dispose of. When you're planning your estate, first determine what is community property and what is separate property. This is not always easy, and the rules vary from state to state. Your lawyer can help you figure out which is which, so that you know what property you can transfer through estate planning.

Joint tenancy: property you own with someone else

Joint tenancy is a legal term that means, effectually, "co-ownership." If you and your spouse (like Darren and Samantha) buy a house or car in both your names, each of you is considered a joint tenant and has co-ownership. When one of you dies, the other joint tenant immediately owns it all, regardless of what either of you says in your will.

Joint tenancy (sometimes called **survivorship**) can be a useful way to transfer property at death. Family automobiles and bank accounts often pass that way. Particularly in old age, people often place bank accounts or stocks in joint tenancy with their spouses, one or more children, or friends. When one of the co-owners dies, joint ownership in many states gives the other ones instant access to the account to help pay bills. The transfer avoids probate, lawyers, and court fees. Many states have adopted the Uniform Probate Code, which creates a presumption that joint property be conveyed to the surviving owner at death.

Should you put property in joint tenancy as part of your estate planning? The answer will vary depending on your circumstances, but most estate planners urge caution, particularly if your estate is above the federal estate tax level. Even for small estates where taxes aren't an issue, however, there can

be pitfalls.

ELEVEN TIMES WHEN JOINT TENANCY IS NOT A GOOD IDEA

Joint tenancy is not a panacea. Here are some tips about when to avoid it.

1. When you don't want to lose control. By giving someone co-ownership, you give them co-control. If you made your son co-owner of the house, you couldn't sell or mortgage it unless he agrees. (If he later marries, his wife may also have to agree.) If you do sell it, he may be entitled to part of the proceeds. Joint ownership of stock also means you've lost control. If you put your daughter on your stock accounts as a joint tenant, she could veto transactions.
2. When the co-owner's creditors might come after the money. If creditors come after your co-owner, they may be able to get part of the house or bank account. For example, creditors could attach your co-owner's half of your joint bank account, or get a lien on his half of the house, which could prevent you and him from selling it. (Of course, they couldn't sell it either, but they'd have a club over his--and your--head.)
3. When you can't be sure of your co-owner. You and your co-owner could have a falling out, and the co-owner could take all the money out of the bank account. There's nothing you could do about it, since the person is a co-owner. What was created for convenience may turn into a nightmare. (Some states have **convenience accounts**--also known as **pay on death** accounts--that avoid some of these problems while allowing the co-owner to write checks and so on.) And, in many states, someone who jointly owns real estate can force a sale of the property without the owner's consent, no matter how small a portion he or she owns.
4. When you're using co-ownership to substitute for a will. Joint tenancy doesn't help if all the joint

tenants die at once, so each needs a will. Nor does it answer where your property goes if the younger joint tenant dies first, so you still need a will. And if you put one child's name on an account assuming he'll divide the money equally among the other children, know that he is on his honor and legally can do with it what he pleases. On top of all this, the transfer of property setting up this type of ownership could result in adverse income tax consequences when the surviving beneficiary sells the appreciated property.

5. When it might cause confusion after your death. Your mother makes you a joint owner of her bank account, so you can help her with her shopping and bill-paying. Whom does she intend to own that account when she dies? Often, nasty lawsuits ensue between the original owner's estate and the surviving joint tenant. A common question: did the owner put the property in joint tenancy to make a gift to the surviving tenant, or was the joint tenant really a co-manager of the business or property?

6. When it won't speed the transfer of assets. Some states automatically freeze jointly owned accounts upon the death of one of the owners until the tax collector can examine it, so the surviving partner can't count on getting to the money immediately.

7. When it compromises tax planning. Careful planning to minimize the taxes on an estate can be thwarted by an inadvertently created joint tenancy that passes property outright to a beneficiary. For example, passing property by joint tenancy can increase estate taxes by preventing transfer to the children through a tax-avoiding **bypass trust** (see [chapter eight](#)). It can also increase gift taxes--the IRS may consider adding a joint tenant to be taxable gift giving. (There are, however, no gift tax implications for joint bank accounts until the co-owner makes a withdrawal, nor for savings bonds or stocks held by a broker.)

Many of these problems occur with **institutional revocable trusts** and **pay on death** forms of ownership of bank, broker, and mutual fund accounts and savings bonds. If you own any of these kinds of property, be sure you understand what happens to them when you die, and plan accordingly.

Or suppose your aging mother calls you and asks if she can list you as a joint owner of her bank account. That way, you can buy her groceries, pay her bills, and so on. It would make things so much more convenient for her, since her memory isn't what it used to be and it's hard for her to get around. You agree.

Then, the unexpected happens: you are killed in a car accident. In many jurisdictions, the law will include the value of that bank account in your estate. (The money will revert to your mother, but for tax purposes the account could be considered part of your estate, along with everything else you owned that will pass to someone else upon your death.) If the account was large, your estate could grow suddenly from a modest one that had no tax concerns to one that will be hit hard by the estate tax. Had your mother put that money in a trust, or sheltered it in some other way, that tax could have been avoided. Now, a good part of your children's inheritance will have to go instead to the federal government.

8. When you're in a shaky marriage. Your individual property becomes joint marital property once it's transferred into joint names.

9. When one of the co-owners becomes incompetent. If one of the co-owners becomes legally incompetent to make decisions, part of the property may go into a **guardianship**--making it cumbersome at best if the other joint tenant wants to sell a house or some stock.

10. When you don't want to transfer assets all at once. Joint tenancies deprive you of the flexibility of a will or trust, in which you can use gifts and asset shifts to minimize taxes, and pay out money over time to beneficiaries, instead giving it to them all at once

11. When it raises taxes. In a community property state you get a tax advantage from holding the property as community property, rather than joint tenancy. (Both halves are valued for tax purposes at their worth upon transfer, not just one half).

Joint tenancy does have its advantages. It's inexpensive to create, for example--you probably don't need a lawyer to buy an asset jointly. But the ultimate costs can far exceed these initial savings.

Most of the advantages of joint tenancy can be achieved using a simple **revocable living trust** (see chapter five). And a device called a **beneficiary deed** can accomplish many benefits of joint tenancy with few of the risks. (Check with your attorney to see if it's available in your state and useful to you.) Also, your state may allow pay on death bank accounts that will give whomever you name as beneficiary access to the account at your death. This is a form of co-ownership that only becomes active when the account holder dies. It's a good way to get money to beneficiaries at death but not before. Coupled with a power of attorney, it can retain ownership in your hands while you're alive, while giving your beneficiary management authority. As noted above, though, it could have estate tax consequences, so check with your bank, accountant, or lawyer. Finally, chapter eight discusses the possible tax advantages for spouses who put property in their names separately instead of owning it jointly.

Tenancy in common

Don't confuse joint tenancies with **tenancies in common**. (It's easy to do, especially when a state law deems an asset held in joint tenancy as titled "jointly as tenants in common.") In joint tenancy, you and your spouse both own the whole house, which means, among other things, you must both agree to sell it. In tenancy in common, on the other hand, you each own a half-share of the house, and either of you may sell your half-share without the other's consent (although not many buyers are interested in purchasing half a house). In tenancy in common, different partners can own unequal shares of the property. For example, your will might leave your vacation home to your three children as tenants in common, but you might give the child who uses it most often or could manage it best a 51% share while

the others share the rest.

Another difference: if you own an asset in joint tenancy with anyone and you die, ownership of that asset passes to the other joint tenant automatically. In a tenancy in common, your share passes as provided in your will or trust, with possible probate, estate tax, and other consequences. Tenancy in common can be less risky than joint tenancy, and is especially useful for larger estates in which you give shares of property to the children during your lifetime. Ask your lawyer if it might be useful in your estate planning.

Inter vivos gifts: giving it away before you die

Federal tax laws now encourage people to transfer property through means other than their wills—often before they die. Trusts are the most common means, but you can also make cash gifts.

Are gifts made while you're alive (**inter vivos gifts**) a good idea? Maybe, especially if you have a large estate: they can help you avoid high death taxes. Or, in some states, they might help you to make a small estate smaller and thus to avoid full-fledged probate. Another advantage of giving property away before you die is that you get to see the recipient enjoy your generosity.

You have to watch out for a few things, however. Inter vivos gifts beyond a certain size are subject to gift taxes. Current law permits you to give up to \$11,000 per person per year (\$22,000 if a couple makes the gift) before the tax kicks in. You can make gifts to any number of people, and they don't have to be related to you. You can also make gifts to trusts and to charities.

You should state in your will that any gifts you have given before you died to a beneficiary will not be considered an **advancement** (a gift that is to be subtracted from the amount a beneficiary is left in a will or trust). If you don't, the probate court in some states may subtract the amount of the gift from the amount you gave him or her in the will. For example, suppose you write a will that leaves your

son \$25,000. A month later you give him \$10,000 for a year of college. Then, a month after that, you die. If your will didn't state that any gifts, like the \$10,000, weren't advancements, the probate court might subtract the \$10,000 from the \$25,000, and your son will wind up with \$10,000 less than you intended. If you do intend that the gift be an advancement, it's a good idea to put that in writing, so the court will reduce the amount he'll receive through your will or your state's intestate succession laws .

The bottom line

This chapter doesn't cover all the ways of transferring property without a will. Other strategies, such as **taking against the will** and **prenuptial agreements**, are covered in chapter seven.

The main thing is to be aware of the kinds of property that a will doesn't cover, so you can use them in your estate planning if they're right for you. You should also keep records of all these items and your other assets in a single place, and, to avoid confusion, mention their existence in your will. This makes estate planning easier for you and locating your assets easier for your family after you die.

Sidebar

PROPERTY THAT DOES NOT PASS VIA A WILL

- property held in joint tenancy
- life insurance payable to a named beneficiary
- property held in a trust
- retirement plans payable to named beneficiaries, including IRAs, Keogh accounts, and pensions
- bank account trusts (including pay-on-death accounts) payable to a named beneficiary

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