Probate Avoidance – Common Techniques and Unfortunate Pitfalls

By ROBERT H. EARDLEY, Esq., Florida Bar Board Certified Wills, Trusts & Estates Attorney

Simply put, "probate" is the court-supervised, statutory process required by law to transfer ownership of a deceased person's property to the heirs.

Although this sounds innocent enough, prudent advice dictates that probate should be avoided if possible. This is because probate often proves to be a slow, expensive and unnecessary burden – particularly at a time of grief and loss.

PROBATE AVOIDANCE

Techniques and Pitfalls

There are several options available to avoid probate. However, each option has its own particular pros and cons. Therefore, there is no "one size fits all" probate avoidance technique.

The main techniques that avoid probate are (1) joint ownership, (2) asset beneficiary designation to heirs, and (3) a Revocable Trust.

Technique No. 1

Joint Ownership

Most assets, such as accounts and real estate, may be individually-owned or jointly-owned. Individually-owned assets generally are subject to probate. However, jointly-owned assets (with survivorship rights) pass upon one owner's death to the surviving owner, without probate.

For example, a jointly-owned bank account typically is transferred by the bank, free of charge, to the surviving co-owner. And jointly-owned real estate is transferred by filing several abbreviated documents in the county public records.

Pitfalls

One risk of joint ownership – particularly with a higher value account – is that usually each joint owner has unrestricted access to the account. Thus, the use of joint ownership in any situation must be viewed with great caution.

A second pitfall of joint-ownership is that it may result in significant and unexpected federal estate and gift tax consequences.

Finally, a jointly-owned asset "by-passes" one's estate plan (i.e. Will or Revocable Trust) because it passes at death directly to the surviving co-owner. Although probate is avoided, this by-passing of the estate plan, if not well-advised, may ultimately result in significant tax liability – largely due to the under-utilization of the deceased's estate tax and/or generation-skipping tax reduction planning set forth in the estate plan.

Also, this by-passing of the estate plan often results in one heir (the joint owner) receiving a larger share of the estate.

Technique No. 2

Asset Beneficiary Designation to Heirs

Certain types of assets pass at death directly to one's heirs, without probate, under a "beneficiary designation form" executed by the owner.

The most common examples of such beneficiary designated assets, or "BDAs," are IRAs, life insurance, annuities and 401(k)'s.

Importantly, to ensure probate is avoided with a BDA, beneficiaries must be designated, by name, on the beneficiary form. And at death the bank or company holding the BDA will simply transfer the funds directly to the named beneficiaries.

Pitfalls

Although there are several pitfalls to the BDA, the most common is that the beneficiary designation may inadvertently transfer the BDA to the "wrong" person.

For example, Mrs. Smith designates her 4 sons, by name, as heirs of her $1 million IRA using the standard BDA form for XYZ investment company. Unfortunately, Mrs. Smith later develops Alzheimer's disease and then her oldest son, John, predeceases her. And now Mrs. Smith, due to incompetency, can no longer legally update her beneficiary designation.

Who inherits John's $250,000 share of the IRA upon Mrs. Smith's later death? It may be John's children, or his brothers, or his wife – or even Mrs. Smith's probate estate.

A second pitfall with the BDA is that, upon death, the BDA may be subject to increased or accelerated income tax, the estate tax and/or one's creditors, if one's BDA and estate planning documents are not properly coordinated.

In either situation, it is well-advised to have an attorney draw the beneficiary designation for the BDA to properly address contingencies and minimize tax concerns.

Technique No. 3

The Revocable Trust

A Revocable Trust (or "RT") is often the best recommendation to avoid probate. The RT provides many of the same features as does a Will – but it has the added benefit of probate avoidance.

The RT avoids probate because, by law, assets which are legally titled in one's RT at death simply are not subject to the probate system.

With most RTs, the client typically designates himself or herself as the initial trustee and the sole beneficiary, and also retains the right to amend or revoke the RT. And at death the trustee designated by the client (perhaps the oldest child) then takes the helm and transfers the RT assets to the designated heirs, free of probate.

Pitfalls

For one's assets to avoid probate, it is essential that all property otherwise subject to probate be legally transferred to the RT before death. Therefore, one must be diligent to ensure that all "probate-able" property, whether presently owned or acquired in the future, is owned by the RT.

However, it is not uncommon that a client either fails to transfer all assets to the RT at its creation or, years later, acquires a new asset (i.e. the long-desired North Carolina cabin) and forgets to transfer it to the RT.

Also, a common misconception about the RT is that it provides creditor protection. Although other types of trusts can provide creditor protection, an RT does not.

The comments expressed herein are intended for general informational purposes only and should not be relied upon as legal advice. Please consult legal counsel to obtain specific advice for your situation.

ROBERT H. EARDLEY is a Florida Bar Board Certified Wills, Trusts and Estates attorney, holds his J.D. degree from the University of Kentucky College of Law and a Master of Laws (LL.M.) degree in Estate Planning from the University of Miami School of Law. Mr. Eardley is a partner with the Naples law firm of Salvatori, Wood & Buckel, and he or his assistant, Sue Sprouse, can be reached at (239) 552-4124.