Common Estate Planning Pitfalls

Estate planning is complicated. There are a lot of moving parts to organizing your finances and determine where they will go after your death. And in many cases, people simply sign a stack of documents at their attorney's office and think the job is done.

The result? A lot of mistakes, a lot of people falling into estate planning pitfalls. Here are a few that you should try to avoid.

1) Naming the wrong executor. These are the people who are appointed to take legal control over the assets when you pass away. Executors collect all the assets of the deceased, pay final debts and expenses, and file federal and state estate tax returns (if needed). Unfortunately, it is not uncommon for the named executor, years after the documents have been signed, to be deceased or no longer suited for the position because he/she is too elderly. If a professional is named, is the attorney or CPA still in business? Meanwhile, children who were too young to serve when the documents were signed may now be capable of taking on the executor role.

Solution: periodically check to see who has been named as the executor in the estate documents. Is that still appropriate?

2) Not updating documents to reflect the maturity and financial conditions of the children. Estate planning documents that were created when children were young will have named a guardian, but when the children reach maturity, that would no longer be necessary. The document may leave assets to trusts on behalf of the children, when it makes more sense to distribute them directly to the adults they have become. And in some cases, an unequal distribution of assets might make sense, if one adult child has become financially successful while others are struggling. Finally, when children are minors, they typically don't need health care powers of attorney, living wills or advance health care directives. Once they become adults, they should consider having these documents in their own right.

Solution: check to see the provisions in your will or trusts that relate to the children, and update as necessary.

3) Inappropriate health care directives. Under the Health Insurance Portability and Accountability Act, every individual's medical records and other personal health information is confidential, meaning it cannot be shared with anyone, including family members, without written authorization. Lack of this information and specific directives could impede decision-making by others when you're incapacitated or approaching the end of your life.

Solution: check and update your family's health care powers of attorney, living wills and advanced health care directives.

4) Inappropriate estate tax provisions. In 2019, individuals are legally permitted to transfer assets valued at $11.4 million ($22.8 million for married couples) free of federal estate and gift taxes. But outdated estate documents might include planning that was appropriate for much lower exemption values—for example, forcing a trust for the heirs to be funded up to the applicable exclusion amount, which might impoverish the surviving spouse.

Solution: review the formulas in the estate documents with your attorney and/or tax professional.

5) Estate documents drafted in a state where you no longer reside. Every state has its own estate and income tax laws; some are common law property states while others are drafted with community property laws. There can be significant differences between them when it comes to transferring assets. Moreover, 17 states also impose some form of estate or inheritance tax, with different exemption amounts. Some estates that would not be subject to a federal estate tax might be subject to state estate taxes. If your documents were drafted in a different state from where you currently reside, they could be outdated and misapplied.

Solution: review your estate plan to see if it is still appropriate, with an eye toward reducing state estate taxes and making sure they reflect your current residency.

6) Not utilizing portability. The federal estate rules say that a surviving spouse can take advantage of any unused portion of the spouse's exclusion amount. But that's only true if the estate files a federal estate tax return within nine months of the deceased's passing. (This can go up to 15 months if an extension is granted.) In the normal case where the deceased's estate would not have to pay estate taxes, often nobody realizes that the federal estate tax return (showing zero taxes have to be paid) has to be filed. This can be costly in some larger estates, where the second spouse dies with more than $11.4 million in wealth.

Solution: Some families set up a credit shelter, bypass, family or exemption trust that would be funded with assets from the first spouse's estate. That preserves not only the portability of those assets, but any growth in those assets would not be counted in the estate tax calculation. The surviving spouse could also disclaim part of the deceased's assets, allowing them to pass to the children. Or the executor of the estate can file the federal estate tax return, preserving the portability of $11.4 million of additional estate tax exemption.

7) Failing to plan for capital gains taxes. Most estates will never pay a federal estate tax, which means that the tax planning should be concentrated on income tax planning. One important consideration is the step-up in basis for appreciated assets, which means that, for the heirs, the capital gains tax obligation on the amount of appreciation during the deceased's time of ownership will vanish. This is the closest thing to a free lunch, in the tax world, that you can get.

Solution: Save some highly-appreciated assets like legacy stock positions and shares of the family business from the normal rebalancing and diversification activities, and pass them on to heirs.

Source: https://www.fidelity.com/viewpoints/wealth-management/estate-planning-common-pitfalls

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