Five Fatal Estate Planning Mistakes
(And How to Avoid Them)

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INTRODUCTION

For most people, estate planning is a relatively straightforward process. However, there are a few false assumptions some have going into the process as well as pitfalls waiting around every corner that can produce disatrous results. Below are five things most people should consider when creating an estate plan.

MISTAKE #1 – Not Delaying Distributions to Young Beneficiaries

Unless your living trust contains provisions specifying a certain age for your beneficiaries to inherit, the default is for them to receive their inheritance right away. Although a minor's inheritance will be placed into a UTMA Account with some controls, an eighteen-year-old can hardly be considered an adult from a maturity standpoint.

Although we like to think our legacies will benefit our children, a hundred thousand dollars landing in the lap of a college student could be disastrous. Not only is a warped view of the value of money likely, but statistics also show that a young person is more prone to engage in behavior that is a high risk to their health and financial future. You know your children best but consider including a minimum age for them to inherit.

MISTAKE #2 – Failing to Include an Existing Life Insurance Policy

Like Mistake #1 above, a life insurance policy does not discriminate on its beneficiaries' maturity. Upon your death, the policy pays out. Period. Also, even if a beneficiary is financially mature, a death benefit is usually "forced" upon them regardless of whether they are in a messy lawsuit, bankruptcy, or divorce: all situations that could put the death benefit in jeopardy. Consider naming your living trust as the beneficiary of your life insurance so that the death benefit flows into it and is then subject to all of the provisions and protections the trust offers.

MISTAKE #3 – Assuming Beneficiaries Will Make Future Distributions

Occasionally clients will name one beneficiary to inherit some or all of the estate with the intent that that beneficiary will "take care of" other family members and make subsequent distributions on behalf of the deceased. I have seen multiple reasons for clients wanting to do this. Still, most often, the client has quite a bit of confidence in the chosen beneficiary and will exercise further discretion to make distributions as they feel most appropriate. Although not always, but this usually takes the form of a client leaving everything to a child, hoping they will later carve out portions for grandchildren. Not only are you taking on the risk that the child won't comply with your wishes, but there will also likely be adverse tax consequences for both the child and the grandchildren.

Although there are many different ways to address this, first and foremost is to flesh out your thoughts and be specific in how you want things structured. Also, consider carving out gifts to these "other family members" of particular dollar amounts.

MISTAKE #4 – Relying on an Outdated A/B Trust

For many years the Estate Tax applied to a majority of individuals and families since the exclusion was so low. When the Estate Tax Exclusion is low, less and less estates are under that exemption amount and thus subject to taxes. To combat a low exclusion amount, attorneys would recommend "A/B Trusts" which would effectively double the exclusion

Amount for a married couple. For example, if the Estate Tax Exclusion was $1,000,000, a married couple with an A/B Trust could accumulate up to $2,000,000 of net worth without any tax liability. The tradeoff of an A/B Trust, however, was that taxable capital gains for roughly have of the estate carried over to the beneficiaries. With an Estate Tax rate hovering around 40% and a Long-Term Capital Gain rate at about half that (and with gains only being a fraction of overall net worth), it was a tradeoff that was well worth it.

Fast forward to 2017 when the Tax Cuts and Jobs Act raised the Estate Tax Exclusion to $11,000,000! Although an A/B Trust sill expands that to $22,000,000 for a married couple, such a benefit would be needed by only a small percentage of the population. But the tradeoff is still there. In other words, in exchange for an uneeded benefit, a married couple with an A/B Trust passes on taxable capital gains to their beneficiaries for no reason.

The traditional A/B Trust is inflexible and penalizes individuals and families in this type of situation. Currently, trusts are being drafted with much more flexibility in mind which effectively allows the surviging spouse to look at the current tax law and their own net worth and decide which tax benefit is better for them.

Unfortunately, A/B Trusts are everywhere, and if you have one, you could be unnecessarily subjecting your children to tax liability at the time of your death.

MISTAKE #5 – Choosing Successor Trustees for the Wrong Reasons

Clients will often immediately defer to their oldest child to act as the first successor trustee to manage trust assets and administer their estate. In the alternative, clients, intending to avoid conflict, will name all of their children to act together as co-trustees.

The role of a trustee requires a unique skillset of both objective and subjective personality traits. Not only should the trustee be good with numbers and organization, but should also be a peacemaker with a high degree of emotional intelligence. When a loved one dies and their legacy is ascertained and disbursed, emotions run high.

When choosing a successor trustee, take the time to consider the above qualifications. Even though every family is different, the ability to perform the responsibilities to the satisfaction of the other beneficiaries, regardless of personality, is important. In lieu of choosing a family member to fill this role, you can also consider naming a professional, corporate trustee to act. Although there is a fee associated with their services (typically 1% of the estate or less), the act objectively and allow family relationships to remain how they are without forcing unfamiliar dynamics.

CONCLUDING THOUGHTS

Perhaps the most disastrous mistake of all is to procrastinate the creating of a living trust in the first place. In almost every situation, having a flawed living trust is better than having no trust at all. If you do decide to create a trust, be sure to take the time to consider all of your available options and how they can benefit you and your family.

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