Key Wealth Institute

Know Your Estate-Planning Fundamentals – How Assets Can Pass to Beneficiaries

With so much focus on potential changes in estate and income taxation lately, it's not surprising that basic estate planning has taken a back seat to tax planning. But without a solid foundation in estate planning, you can't take advantage of more advanced tax-planning techniques.

So we must not ignore the basic fundamentals of estate planning.

How you own your assets and whether they'll go through probate when you die is equally important. Probate is the legal process for distributing someone's assets after they pass away. The procedure varies from state to state, but it generally involves proving the validity of a will, settling debts and taxes, and distributing assets to beneficiaries.

Without a valid will, the estate is distributed according to the rules of intestacy of the state in which the decedent last resided. This distribution may not be what the decedent wanted. In either case, testate or intestate, the probate process involves extra cost and mandatory probate court filing and is open to public scrutiny.

The probate process may not be as cumbersome as some allege, but many prefer avoiding it. In this article, we'll discuss the most common non-probate dispositions, including the revocable trust, which offers perhaps the greatest benefit.

Jointly held assets

Joint tenants is a common method of owning assets such as investment or bank accounts or real property. Jointly held assets have two or more co-owners with either equal or unequal ownership.[1] The most common types of joint ownership are joint tenants in common (JTIC), joint tenants with right of survivorship (JTROS), and tenancy by the entirety.

However, not all jointly held assets avoid probate.

Joint tenants in common occurs when two or more people own a portion of the property. However, a JTIC does not avoid probate. For example, Brad and Steve own real property as tenants in common, each with a 50% ownership interest. If Steve dies first, his interest passes through probate, while Brad continues as the owner of his interest. Probate will administer Steve's 50% interest according to the terms of his will or the rules of intestacy.

Not only will Steve's 50% share go through probate, but Brad is forced to own property with whomever Steve leaves it to, which can be problematic.

In contrast, a JTROS avoids probate. Under the same scenario, if Brad and Steve own property in a JTROS, when Steve dies, his 50% share automatically passes to Brad. The JTROS arrangement avoids probate and passes to the surviving owner regardless of the provisions of intestacy law or testamentary disposition.[2] Note that it is possible to have some owners of property as joint tenants with right of survivorship while also having owners in the same property as tenants in common. For example, Brad and Steve may each own a 25% interest as joint tenants with right of survivorship while being tenants in common with Debbie, who owns 50% of the property. Should Steve die first, Brad becomes a 50% owner as tenants in common with Debbie. Brad and Debbie's 50% shares must now pass through probate.

Tenancy by the entirety works in the same way as JTROS, but it is reserved for married persons, usually in real estate ownership situations.

Beneficiary-designated assets

Assets held with a designated beneficiary also do not pass through probate, but rather by the terms of the contract, i.e., the named beneficiary. Insurance policies and retirement accounts (IRAs, 401(k)s, etc.) are common beneficiary-designated assets, as are bank or investment accounts that are payable on death (POD) or transferable on death (TOD).[3] As in JTROS ownership, the named beneficiary receives the asset when the original owner dies. Unlike JTROS, however, the beneficiary does not have any ownership rights before the owner's death.

Beneficiary-designated assets only avoid probate if a valid beneficiary is named. If not, the asset will pass through probate and be distributed through the owner's will or intestacy. In some circumstances, the contract terms will direct where the assets are paid if no valid beneficiary is named. In most cases, the estate of the owner is named as the contractual beneficiary if no beneficiary is listed.

As with a JTROS, you should periodically review beneficiary-designed assets to make sure the ultimate recipients align with your wishes and the beneficiaries named in your will. A child named in a parent's will as sole beneficiary may be disappointed to learn that the parent's assets were held as a JTROS with a friend and also named as beneficiary of all insurance policies and retirement accounts. The child will only receive assets that pass under the parent's will; in this case, that would be nothing. Worse still, the parent's debts will flow through to the probate estate, which may complicate matters. These complications and remedies are beyond the scope of this article.

Revocable trusts

A revocable trust offers perhaps the greatest flexibility and protection of assets and ease of administration when the grantor dies. There are many different types of trusts, revocable and irrevocable, each with unique characteristics and purposes. The scope of this discussion is limited to the revocable trust, sometimes referred to as a living trust, or an inter vivos trust.

A trust is a contractual agreement with four components:

1. **The maker of the trust,** also referred to as the trustor, donor, or grantor (which we will use).
2. **The trustee,** the person or entity who carries out the trust's provisions.
3. **The beneficiary** of the trust.
4. **The assets in the trust.**

The law and formalities for validly executing a trust vary by state, but any competent person over the age of 18 may establish a trust. Once executed, the revocable trust can hold various individually owned assets, including bank and investment accounts, insurance policies, real estate, interests in closely held corporations, and LLC interests.

In certain circumstances, a trust may be named as a beneficiary of retirement assets. However, the trust cannot be the owner of retirement assets, which would result in additional taxes. In some jurisdictions, joint trusts are common.

Having a revocable trust is beneficial aside from avoiding probate. During its lifetime, the trust can easily receive or transfer assets or can be amended or terminated altogether. The revocable trust has many positive attributes, but avoiding taxes is not one of them.[4] Rather, the real benefit lies in the ease of administration during the grantor's lifetime and avoiding probate when the grantor dies.

Assets properly titled in the trust allow flexibility during the grantor's lifetime. Typically, the grantor serves as the initial trustee of their revocable trust, and the tax ID number for the trust is the grantor's Social Security number. If the grantor/trustee becomes incapacitated during their lifetime, the successor trustee can immediately take over administration of the trust and continue to pay bills etc.[5]

Suppose assets are already titled in the name of the trust, and the grantor becomes incapacitated or is out of the country. In that case, the successor trustee can continue to transact business, allowing much greater ease of administration.

A revocable trust used in conjunction with a power of attorney document can greatly simplify the day-to-day administration of a person's assets. Given the difficulty of some institutions to accept a power of attorney document, a revocable trust also eases administration while the grantor is alive. Should a corporate trustee be serving as trustee, asset management services can be provided.

You should make sure your revocable trust is properly funded by titling assets in the name of the trust in order to receive its lifetime benefits. You can accomplish this by retitling assets in the name of the trustee of the revocable trust. For instance, "Peter Smith as Trustee of the Peter Smith Revocable Trust, dated June 1, 2023."

Bank accounts, investment accounts, and even tangible personal property can be titled in the name of the trust. For real property, an attorney should be consulted to draft a conveyance deed into the trust. The attorney can also assist with any legalities of titling homeowner's insurance and if the property is subject to a mortgage.

It is equally important to NOT fund the trust with assets that shouldn't be placed in trust. A trust should not be named the owner of retirement assets. It is also advisable not to transfer ownership of automobiles to the trust. Although in most instances it is permissible to name the trust as owner of an insurance policy, you should carefully consider who is named as beneficiary of that insurance policy.

Perhaps the biggest benefit of the revocable trust happens when the grantor dies. The trust becomes irrevocable, and the successor trustee takes over the administration and makes distributions in accordance with the trust terms. Assets that are titled in the trust's name before the grantor's death do not pass through probate.

Should assets not be titled in the trust before the grantor's death, then those assets will need to go through probate, if not held in another non-probate asset (i.e., JTROS or by beneficiary designation). In this instance, a so called "pour-over will" is necessary to have those assets pass through probate and then distributed to the grantor's trust. Once inside the trust, assets are distributed according to the terms of the trust.

Primary benefits of the trust

- There is no need to wait for the probate court to allow distribution of the assets. Rather, if the trustee is granted the requisite authority, assets can be disposed of and distributed as soon as possible.
- The terms of the trust are private and not open to public inspection.
- There is no need to file probate inventory, accounting, or affidavit of closing.
- Continuing subtrusts are not subject to ongoing probate court jurisdiction and accounting requirements.
- Out-of-state real property titled in the name of the trust before the grantor's death avoids ancillary probate administration in the state where the property is located.
- Administration costs can be reduced.

Although the trust provides non-probate disposition of assets, a valid will is still necessary. The will ensures that any non-titled assets are distributed into the trust and that all costs of administration, including any potential income and estate taxes, are properly allocated and paid for.

All the tax minimization and other planning techniques available to a testator are fully available to a grantor under the trust document. Specifically, a grantor should be cognizant of the following:

- Your trust beneficiaries need to be in line with the beneficiary designations under your will (if not a pour-over). Conflicts can arise if the beneficiary designations, designation under a will or a JTROS are not the same as with the terms of the trust.
- The revocable trust does not save any estate taxes or income taxes attributable to the grantor but can be drafted to minimize taxes for future generations.
- The same tax-planning techniques can be made under the will or the revocable trust.
- The trust can protect the assets for future generations, such as a beneficiary with difficulty managing finances or a recipient of public-assistance benefits.

For more information, please contact your advisor.

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[1]For the purposes of this article, tax considerations in either creating a joint tenancy or holding assets jointly will not be explored.

[2]Some probate filings are necessary to show ownership vests in the sole surviving owner for recordation on the land records.

[3]The tax implications/payout terms of beneficiary designations of IRAs and other retirement accounts is beyond the scope of this article.

[4]Some trusts do allow minimization or avoidance of estate tax; however, this is not discussed in this article.

[5]Should a trustee other than the grantor be serving as trustee, then a tax ID number may need to be obtained. However, taxation of the assets continues as if still held in the individual name of the grantor while he or she is living.

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