

# **ESTATE PLANNING OR NO ESTATE PLANNING?**

**Thomas F. Kennedy**  
**KENNEDY & ASSOCIATES**  
**Attorneys-at-Law**

**Board Certified**  
**Estate Planning and Probate Law -**  
**Texas Board of Legal Specialization**

**5851 San Felipe, Suite 925**  
**Houston, Texas 77057**  
**(713) 783-7444**  
**(713) 783-6601 (Fax)**  
**E-MAIL: [tkennedy@houstonestateplanning.com](mailto:tkennedy@houstonestateplanning.com)**

**1. Estate Planning Objectives -** There are numerous estate planning objectives. A partial listing of some of those objectives include the following:

- a. Disposition of the estate upon death.
- b. Avoiding disputes and contests.
- c. Reducing the federal estate tax burden.
- d. Avoiding guardianship and the cost of guardianship, disability planning.
- e. Right to die planning.
- f. Health care decisions.
- g. Resource planning and objectives. This must be done in order to protect the surviving spouse and children to make sure there are sufficient assets to protect these individuals.
- h. Protection and conservation of critical family resources.
- g. Protecting a child's inheritance from loss in a divorce proceeding or loss to that child's creditors.
- h. Avoiding or substantially limiting costs incident to probate.
- i. Liquidity Planning.
- j. Control and Management. The estate plan may want to avoid fractionalization of family businesses and other assets because division may cause a loss of value or the ability to produce income.
- k. Flexibility. The estate plan may want to provide administration over a long period of time, and there must be provision for fiduciaries and their successors.
- l. Integration. Coordinate the will or living trust with beneficiary designations, buy sell agreements, joint and survivorship agreements.
- m. Income Tax Planning.
- n. Continuity.

Source: Sixteen Common Estate Planning Objectives, by Larry W. Gibbs, State Bar of Texas, The Building Blocks of An Estate Plan (February 1991).

# **FEDERAL ESTATE TAX AND THE BYPASS TRUST**

## **FEDERAL ESTATE TAX**

- THE ESTATE TAX IS VERY SEVERE BUT WAS MODIFIED FOR 2002 AND THEREAFTER.
  - THE PRESENT ESTATE TAX RATE (AFTER THE EXEMPTION) IS 45%, BUT THE MAXIMUM RATE WILL INCREASE TO 55% IN 2011.
  - INCLUDES ALL ASSETS OWNED BY THE DECEDENT, EVEN LIFE INSURANCE DEATH BENEFIT AND PENSION PLANS.
  - IS DUE NINE (9) MONTHS AFTER DEATH AND IS TO BE PAID IN CASH
- CAN BE REDUCED OR ELIMINATED THROUGH VARIOUS ESTATE PLANNING DEVICES SUCH AS:
  - BYPASS TRUSTS
  - LIFE INSURANCE TRUSTS
  - FAMILY LIMITED PARTNERSHIPS
  - CHARITABLE PLANNING
  - GIFTING
- SPECIALLY DESIGNED LIFE INSURANCE POLICY CALLED SURVIVORSHIP LIFE INSURANCE IS USUALLY THE BEST WAY TO PAY THE ESTATE TAX.

# WILLS AND LIVING TRUSTS

## I. WILLS

### ● SOME OF THE ADVANTAGES OF ESTATE PLANNING WITH WILLS

Wills have been in use for many hundreds of years and they obviously have advantages that are self evident. Some, but not all, of the advantages of Wills are as follows:

1. **INDEPENDENT EXECUTOR.** The testator may pick an Independent Executor to serve without bond. In many instances this streamlines the probate process.
2. **TAX PLANNING.** There may be significant estate taxes savings through the use of bypass trust in a Will the same way as in a Living Trust. Marital deduction planning may also be done.
3. **GUARDIANSHIP PLANNING FOR MINOR CHILDREN.** The testator may plan for Guardianship avoidance for minor children or disabled children.
4. **CONTROL OF PROPERTY THROUGH TRUSTS.** Testator can control the ultimate disposition of property.

### ● SOME OF THE DISADVANTAGES OF WILLS

#### 1. REQUIRES PROBATE

\* There may be delays in property transfer.

\* It may be expensive.

\* Husband and wife's estates must go through TWO probates.

\* **NO PRIVACY** - Probate is a public proceeding. The records of who gets what and what the estate owned are open to the public.

Probate comes at a time of great stress -- the death of someone close.

#### 2. Wills are technical and often difficult to understand.

#### 3. **NO DISABILITY PROTECTION** -- by themselves -- you may have related documents, i.e., Durable power of Attorney, but these documents may not be accepted by all institutions.

4. WILL CONTESTS - Heirs fighting over estate at great expense to the estate.
5. Property located in other states -- may require more than one probate.

## II. LIVING TRUSTS

### ● ADVANTAGES OF LIVING TRUSTS

1. PRIVACY - The assets of a living trust do not go through probate and thus do not become public record. The expense of probate is also eliminated.
2. PROPERTY IN OTHER STATES - Since property is owned by the by the Living Trust, and does not go through probate, there is no need to have ancillary probate in other states as you would have to if you had a will.
3. STRONG DISABILITY PROTECTION - If one of the owners of the assets becomes disabled, then the other trustee, or a successor trustee, manage the assets.
4. PEACE OF MIND - No probate at a very stressful time. No immediate Inventory of Estate.
5. Less likely to have heirs fighting:
  - \* "Standing" issues
  - \* Evidence issues - this was the owner's plan -- he or she put it into effect during their life.
6. Can reduce or eliminate estate taxes in the same way that traditional estate planning can.
7. The owners of the property stay in control during their lifetime.
8. Is revocable -- you may change it or eliminate it during your lifetime.
9. Can provide for outside management.

- **SOME OF THE DISADVANTAGES OF LIVING TRUSTS:**
  1. You may not be able to put all of your property in a Living Trust (or you may forget to put some of your property in a Living Trust), hence some of it may have to go through probate. Some examples of property that may not be able to be placed on a living trust include professional corporation and professional association stock, which may only be owned by the licensed professional who has incorporated.
  2. Placing all of your property in trust and then remembering to title all of the assets that you acquire for the rest of your life into the living trust may be considered a nuisance. For this reason, younger individuals sometimes are less likely candidates for a living trust. However, you have to put all of the assets you acquire into some name any way, so proponents would say that this is not a valid disadvantage.
  3. There may be other disadvantages to a living trust, some of them minor, as there is to Will planning. No estate planning method is perfect. We are only hoping to find the best method for the particular purpose.

## **INTESTACY**

1. Intestacy is dying without a Will. It is estate planning by default. It is often expensive and time consuming.
2. In Texas, if a married person with children dies without a Will, the deceased spouse's community property may pass to the children when there has been a prior marriage, not to the surviving spouse. This may not be the outcome that either the deceased spouse or the surviving spouse intended. There will be no marital deduction for property passing to the children and thus no deferral of estate tax on that property.
3. If a married person with no children dies without a Will, all of the community property and the separate personal property of the deceased spouse passes to the surviving spouse. However, only one-half of the separate real estate passes to the surviving spouse, with the other half being divided between the parents, if both parents are living, if not then some or all to the brothers and sisters of the deceased spouse.
4. Intestacy is often the most expensive process. If you have a Will you can name an Independent Executor to serve without bond who may serve somewhat independent of the probate courts. In a Living Trust you may be able to avoid probate, but in intestacy you are not usually independent of the courts.

# THE FAMILY LIMITED PARTNERSHIP

- A LIMITED PARTNERSHIP IN WHICH FAMILY MEMBERS ARE THE PARTNERS.
- REDUCES OR ELIMINATES ESTATE TAXES.
- ENSURES CONTINUOUS FAMILY OWNERSHIP FROM ONE GENERATION TO ANOTHER.
- SHELTERS FAMILY ASSETS FROM LAWSUITS, TRANSFER TAXATION AND CREDITORS.
- THE CHARGING ORDER: A creditor of a partner (not of the partnership) cannot usually reach partnership assets. In Texas, outside of bankruptcy, and assuming there has not been a fraudulent transfer, creditors of a partner (whether a general partner or a limited partner) have a limited remedy, which is a "charging order".
- CHARGING ORDER limits the judgement creditor to the right to the income portion of the partner's interest in the partnership and a right to inspect the records of the partnership. It does not give the creditor the right to force a liquidation of the assets of the partnership.
- THE GENERAL PARTNER DOES NOT HAVE TO MAKE ANY DISTRIBUTIONS TO THE LIMITED PARTNERS INCLUDING THE JUDGEMENT CREDITOR.
- THE INCOME TAX OF THE LIMITED PARTNERSHIP INTEREST WITH THE CHARGING ORDER MUST BE PAID BY THE JUDGEMENT CREDITOR!
- THE GENERAL PARTNER IS STILL ENTITLED TO A SALARY FROM THE PARTNERSHIP WHILE THE CREDITOR IS PAYING THE INCOME TAXES.
- FRAUDULENT TRANSFER STATUTES MUST BE CONSIDERED.
- ASSETS ARE ENTITLED TO DISCOUNTS FOR PURPOSES OF ESTATE TAX VALUATIONS SUCH AS:
- MINORITY INTEREST DISCOUNTS because limited partners can not control the partnership.
- MARKETABILITY INTEREST DISCOUNTS
- CANNOT TRANSFER ALL ASSETS TO A FAMILY LIMITED PARTNERSHIP.

# ASSET PROTECTION

- **THERE IS AND HAS BEEN A LITIGATION CRISIS IN THE UNITED STATES.** Over 19 million new lawsuits are filed in this country every year.
- **IN ONE RECENT YEAR NINETY FIVE PERCENT OF ALL LAWSUITS FILED IN THE WORLD WERE FILED IN THE UNITED STATES.** Many of these lawsuits are perceived to be frivolous, yet they are often settled for sums far greater than the actual liability. Some industries have been harder hit by this crisis than others.
- **BUSINESS OWNERS, PROFESSIONAL SUCH AS DOCTORS AND ACCOUNTANTS, PROPERTY OWNERS AND PRODUCT MANUFACTURERS HAVE BEEN PARTICULARLY HARD HIT.** Assets which have taken a lifetime to accumulate can be lost as a result of litigation.
- **THERE ARE NUMEROUS TECHNIQUES TO PROTECT ASSETS FROM LOSS AS A RESULT OF LAWSUITS SUCH AS:**
- **SPENDTHRIFT PROVISIONS IN TESTAMENTARY TRUSTS.** The envelope of protection for the spendthrift trust is often stronger than a corporate shield. Texas courts have held that:
  - a) The assets of a spendthrift trust are protected from the judgements and claims of a beneficiary's creditors.
  - b) In a divorce, one spouse cannot reach the assets of the other spouse which are held in a spendthrift trust created for the other spouse. For example, if adult children were left an inheritance in a spendthrift trust, the inheritance would not be lost if the adult child was divorced.
  - c) In one case the Internal Revenue Service could not reach the assets of a spendthrift trust which was created by a husband for his wife.
  - d) Texas courts have also denied governmental claims for institutional care and attempts to seek reimbursement from a spendthrift trust.

Nothing prevents a creditor from pursuing income payments or other property after it has been actually delivered to a beneficiary of the trust. The beneficiary also cannot use the assets of the trust as collateral for a loan prior to his actually receiving the assets of the trust.

- **OFFSHORE TRUSTS.** One of the main reasons for establishing an Offshore Asset Protection Trust is to minimize the risk of losing assets in a court judgement. These trusts

will be established in foreign countries that do not recognize the judgements of the United States courts. Therefore they would require a complete retrial of the case in a foreign court. The cost and the impracticality of requiring a plaintiff from pursuing a suit in a foreign jurisdiction may completely prevent the retrial from taking place.

- FAVORABLE STATUTE OF LIMITATIONS
- JURISDICTIONS DO NOT RECOGNIZE FOREIGN JUDGMENTS.
- FLIGHT PROVISIONS WILL ALLOW THE TRUST TO BE MOVED FROM ONE JURISDICTION TO ANOTHER.
- **PARTITION AGREEMENTS.** The separate property of one spouse is not subject to any liabilities of the other spouse. Thus the separate property of a non-contracting spouse will not be subject to a community debt unless the non-contracting spouse is jointly liable on the debt. Thus, community property can be partitioned into separate property to protect the property if the high risk spouse is sued. Disadvantages include the loss of a step up in basis upon the death of a spouse and loss of the community interest in a divorce.
- **EXEMPT PROPERTY.** In Texas certain property is exempt from seizure for the claims of creditors.
  - **HOMESTEAD.** The homestead is exempt except for a purchase money mortgage, taxes on the property and for work and materials used constructing improvements. A homestead in an urban area consists of not more than ten acres of land together with the improvements. (i.e. the house). A rural homestead for a family cannot be more than two hundred (200) acres or for a single person not more than one hundred (100) acres. A homestead is rural if it is on a piece of property that is not served by municipal utilities and fire and police protection. The proceeds from the sale of a homestead are not subject to seizure by creditors for six months after the date of sale.

How strong is the homestead exemption? It is to be liberally and generously construed. One 1948 Texas case said "The policy of the Courts is to uphold and enforce the homestead laws notwithstanding the fact that in so doing they sometimes directly assist a dishonest debtor in wrongfully defeating his creditors".

- **PERSONAL PROPERTY EXEMPTION.** Property for a family that has an aggregate fair market value of not more than sixty thousand dollars (\$60,000) is exempt from garnishment, attachment, execution or other seizure. The exemption is \$30,000 for a single person.

There is a laundry list of the kind of personal property that can comprise the \$60,000 exemption including home furnishings, tools, equipment, books and apparatus including boats and motor vehicles used in a trade or profession, wearing apparel and jewelry (with a limitation on the dollar amount of jewelry), two firearms and a variety of animals.

- **QUALIFIED PLANS EXEMPTION.** Assets held in or to receive payments, whether vested or not, under any stock bonus, pension, profit sharing or similar plan including a retirement plan and under any annuity or similar contract purchased with assets distributed from that type of plan or under an IRA or Individual Retirement Annuity including a simplified employer pension plan are exempt from attachment. The exemption applies while the assets are held in the plan. Distributions are not exempt from attachment by creditors.
- **LIFE INSURANCE AND ANNUITIES.** All money or benefits of any kind including policy proceeds and cash values to be paid or rendered to the insured or any beneficiary under any policy of insurance or under any plan or program of annuities are fully exempt from execution, attachment, garnishment or other process and are fully exempt from all demands and any bankruptcy proceeding of the insured or beneficiary. Since the enactment of laws in Texas in 1991 and 1993 protecting life insurance and annuities, there have been a number of court cases that have interpreted these laws.
- **LIMITED PARTNERSHIPS.** The Limited Partnership Act greatly limits the remedies of a judgement creditor against a judgement debtor's ownership interest in a limited partnership. A creditor's only recourse against a limited partnership interest is a "charging order" against the percentage of ownership of the debtor in that partnership. The general partner of a limited partnership can prevent the judgement creditor assignee from receiving any of the profits from the limited partnership. All the creditor may receive would be the income tax liability.
- **TEXAS UNIFORM FRAUDULENT TRANSFER ACT.** Any transfer that is determined to be fraudulent can be set aside by a creditor under the TEXAS UNIFORM FRAUDULENT TRANSFER ACT.
  - There are certain "badges of fraud" that accompany fraudulent transfers so frequently that they are perceived as evidence of actual fraudulent intent. Several badges, when found together may infer fraud. Some examples of badges of frauds are:
    - a) transfers to an "insider" which includes a family member or relatives or general partners of the debtor, especially when the transfers are for inadequate consideration;
    - b) secrecy or concealment;
    - c) insolvency;
    - d) transfers while litigation is pending or threatened; or
    - e) transfers where there is still retention of control or enjoyment of the transferred property.

