WRMarketplace
An AALU Washington Report

The WRMarketplace is created exclusively for AALU members by experts at Greenberg Traurig and the AALU staff, led by Jonathan M. Forster, Steven B. Lapidus, Martin Kalb, Richard A. Sirus, and Rebecca Manicone. WRMarketplace #17-04 was written by Greenberg Traurig Shareholder Jonathan M. Forster.

The AALU WRNewswire and WRMarketplace are published by the Association for Advanced Life Underwriting® as part of the Essential Wisdom Series, the trusted source of actionable technical and marketplace knowledge for AALU members—the nation's most advanced life insurance professionals.

Thursday, 26 January 2017 **WRM# 17-04**

TOPIC: What Happens if You Die Without a Will? A Cautionary Tale.

MARKET TREND: Although most individuals want to provide for their families after they pass, some estimates show that over half the U.S. population still lacks even basic Wills. This trend is heading in the wrong direction, so the question remains – can advisors help?

SYNOPSIS: When an individual dies "intestate," or without a Will, assets that do not pass by a beneficiary designation or based on survivorship or similar rights, are distributed according to state intestacy laws. These statutes vary by state, and individuals are often surprised to learn that they do not dispose of an individual's assets as expected. Moreover, intestacy laws do not consider the impact of federal and state estate taxes or incorporate any asset management or creditor protection planning.

TAKE AWAYS: Having a properly executed legacy plan (a Will, or Will and revocable living trust) is the best way to ensure that estate assets pass to the intended beneficiaries in the desired manner. Planning is particularly critical for blended families, as state laws may leave more or less than desired to a surviving spouse or children from a prior marriage.

Only with a legacy plan can individuals manage their estate tax liability, ensure distribution of specific assets to certain beneficiaries, and provide for creditor protection, long-term planning, and professional asset management for their beneficiaries.

PRIOR REPORT: 16-40.

State intestacy laws govern the disposition of an individual's assets when he or she passes without a Will. Many individuals may be surprised to discover that these laws differ from state-to-state. They also underestimate how greatly intestate distribution can vary from their wishes, giving them false comfort that they can put off planning until a "more convenient time." As shown in our cautionary tale, however, implementing a legacy plan is crucial as intestate distribution can have adverse effects and may cause a bereaved family more pain and conflict.

INTESTACY LAWS: AN OVERVIEW

When a person dies without a Will, state intestacy laws apply to distribute "probate" assets, generally assets that do not pass by beneficiary designation or based on the titling of the asset, such as jointly-titled assets with rights or survivorship (i.e., "non-probate" assets). Every state has laws addressing intestate succession, and most generally provide that probate assets pass to the surviving spouse if there are no descendants or if all descendants of the decedent are also descendants of the surviving spouse. If there is no surviving spouse, typically probate assets will pass to the decedent's descendants, or if none, then to more extended family members as one proceeds further along the chain of ascent/descent (e.g., to surviving parents, if none, then to surviving siblings, etc.). Yet there can be important and potentially unexpected differences in state intestate distributions, especially if there are descendants from multiple relationships and/or marriages.[1]

INTESTACY IN ACTION: A CAUTIONARY TALE

<u>The Family</u>. Harry, age 46, and Wendy, age 33, have been married for four years. It's Harry's second marriage and Wendy's first. They have three young children, Aaron, age 3, and the twins, Beth and Brian, age 1. Harry has a daughter from his first marriage, Chelsea, age 21. He also has a brother, David, but they have been estranged for many years since Harry bought David out of the family business. Neither Harry nor Wendy has done any estate planning -- with three young children and a business to run, there never seemed to be a good time. Sadly, Harry passed away unexpectedly. At the time of his passing, he owned the following:

Harry's Assets (owned in sole name unless otherwise indicated)	Estimated Value
H. Co. – family business	$19,000,000
Primary residence (jointly-owned with rights of survivorship with Wendy)	$1,500,000
Vacation residence	$800,000
Personal checking account	$200,000
Brokerage account	$1,000,000
Retirement account (Wendy is the designated account beneficiary)	$1,500,000
Life insurance death benefits on Harry's life (David is designated policy beneficiary)*	$1,000,000
Grand Total	**$25,000,000**

*This policy was purchased for business purposes when David was still involved with the family company. Harry wanted to change the beneficiary designation, but never got around to it.

<u>Harry's Wishes</u>. Harry planned to leave all his assets, except the life insurance, in trusts for Wendy's benefit, with the remainder passing in further trusts to Aaron, Beth, and Brian after Wendy's death. Harry understood that he could structure the plan to help manage the total estate taxes due at his passing and to use distributions in trusts (as opposed to outright) to provide both creditor protection and professional asset management for his family.

Harry planned to leave only the life insurance death benefits to Chelsea, because he knew that Chelsea's maternal grandparents had provided her with a substantial trust fund.

<u>Actual Outcome</u>. Unfortunately, Harry's wishes have no impact on the actual distribution of his assets, since he failed to put a Will or other estate plan in place. So, who will receive Harry's assets after his passing?

Non-Probate Assets. Regardless of Harry's state residence at death, his $4 million in non-probate assets will pass per their beneficiary designations or by operation of law, as follows:

Beneficiary/Asset Receive	**Value**
Wendy	
Primary residence	*$1,500,000*
Retirement account	*$1,500,000*
Wendy Total Non-Probate	**$3,000,000**
David Total Non-Probate (Life Insurance Death Benefits)	**$1,000,000**

Practical Comment: Although the primary residence and retirement account pass to Wendy, as Harry desired, David receives the insurance death benefits because Harry failed to update his beneficiary designation, something Harry surely did not want. Accordingly, along with implementing a Will, individuals must review and coordinate the beneficiary designations and titling of their non-probate assets.

Probate Assets. Distribution of Harry's remaining assets (his "**probate estate**"), worth $21 million, will vary depending on the intestacy laws of his state residence at death. To see the potential disparities among states, compare some of the possibilities:

Beneficiary	New York	Florida	Virginia
To Wendy (surviving spouse)	$50,000 + ½ probate estate ($10,550,000)	½ probate estate ($10,500,000)	$^{1}/_{3}$ probate estate ($7,000,000)
To Harry's Four Children (total)	Remaining estate ($10,450,000)	½ probate estate ($10,500,000)	$^{2}/_{3}$ probate estate ($14,000,000)
To Each Child (equal shares)	$2,612,500	$2,625,000	$3,500,000

Practical Notes. Chelsea could receive up to $3.5 million, not the $1 million Harry intended. Further, Wendy could be deprived of up to $14 million for her support and lifestyle. She will have no access to Chelsea's assets, and, although she will control the assets passing to her children, as their guardian, she must use the assets solely for their benefit and support, not hers, even if she needs them.

Manner of Distribution. Whichever state law applies, ***all intestate estate assets pass outright, with no regard for tax or creditor protection planning and with no allocation of a specific asset to a desired individual***. In Harry's case, this could cause significant issues, especially for his business. Chelsea and three minor children could receive business interests, surely complicating business succession or sale planning after Harry's death.

Further, Wendy will have full control over her intestate share and may dispose of it in any way desired, including for the benefit of another spouse if she remarries. There also is no multi-generation planning or use of Harry's generation-skipping transfer tax exemption to defer further estate taxes for descendants, arguably a huge financial loss.

For many families, defaulting to intestacy laws for distributions of an estate will be inefficient from a succession and tax perspective and will fail to provide sufficiently for long-term planning for children and other beneficiaries.

Payment of Taxes & Expenses. In addition to debts and administrative and funeral expenses, intestate distribution could result in the immediate payment of federal estate taxes upon the passing of the first spouse. In Harry's case, assuming Virginia law applies, $15 million of assets will pass to non-spousal beneficiaries ($1 million of non-probate assets to David + $14 million of probate assets to children), making it ineligible for the federal estate tax marital deduction. After applying a currently-available federal estate tax exemption of $5,490,000, Harry's estate would still owe over $3.8 million in federal estate taxes (at a 40% rate) immediately at his passing, instead of possibly being deferred until after Wendy's passing. State estate taxes also could apply, depending on the state.

The payment of these expenses, debts, and taxes will be determined by applicable state law, including the state's tax apportionment statute. These statutes may or may not apportion the tax liability proportionately among probate beneficiaries or allocate any of the tax liability to non-probate assets, leaving the probate beneficiaries to bear the entire burden. For example, even though the $1 million in life insurance proceeds passing to David is taxable, he may not bear any portion of Harry's estate tax, leaving Harry's probate estate, likely the assets passing to his children, to bear the entire burden (since assets passing to Wendy qualify for the marital deduction). For a further discussion of how apportionment statutes may apply, see *WRMarketplace No. 16-40.*

TAKE AWAYS

Having a properly executed legacy plan (a Will, or Will and revocable living trust) is the best way to ensure that estate assets pass to the intended beneficiaries in the desired manner. Planning is particularly critical for blended families, as state laws may leave more or less than desired to a surviving spouse or children from a prior marriage. Only with a legacy plan can individuals manage their estate tax liability, ensure distribution of specific assets to certain beneficiaries, and provide for creditor protection, long-term planning, and professional asset management for their beneficiaries.

NOTES

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[1] While this report focuses on separate property states, whether the decedent is resident in a community property state will also impact intestate distribution vis-à-vis the share passing to the surviving spouse.