Avoiding Probate

Certain well-defined rules govern the administration of an estate. These rules are designed to accomplish three goals:

1. Conserve estate assets.

2. Protect the rights of the estate's creditors in the satisfaction of their claims.

3. Ensure that heirs and beneficiaries receive their inheritance in accordance with the estate owner's wishes.

All states have enacted statutes providing machinery for the realization of these goals. The functioning of this machinery is placed under the control of probate courts set up especially to oversee the process of estate administration, from appointment to final discharge of the personal representative.

The Probate Courts

The courts charged with estate administration responsibility often are known as probate courts. The term probate is simply the Latin word meaning "prove." When used in conjunction with a decedent's will, for example, it refers to the process of proving the authenticity of that will.

The ultimate goal of estate administration is the systematic distribution of a decedent's assets to those entitled to them, whether by virtue of their claims as beneficiaries or as creditors. This, then, becomes the goal of the probate court, and the entire process is at all times under its direction and subject to its control.

Control by the probate court generally begins with the appointment of the personal representative. This control continues until the administration is concluded, distribution of the assets is made and the personal representative is discharged.

Avoiding Probate

Transferring a decedent's property without using the probate courts is commonly known as avoiding probate. Avoidance can be complete or partial. Complete avoidance is rarely possible because there are normally some assets that must pass through the probate courts. Before deciding whether estate assets should bypass probate, the benefits and drawbacks of avoidance should be carefully weighed.

The Probate Process

The probate process generally involves the following: (1) establishing the validity of a will (proving that the will offered for probate is the decedent's last will and was validly executed and witnessed), (2) settling

a decedent's estate, (3) supervising the passage of a decedent's property without a will, (4) protecting the interests of minors and incompetents, (5) determining spousal rights, (6) overseeing any will contests, and (7) determining the powers associated with these subjects and who holds these powers. During this time there are executor's fees, administrator's fees, commissions, attorney's fees, court costs and other expenses. These expenses can add up to 10 percent of the value of a small estate. Once a will is submitted to probate, it will be open to the public both during the proceedings and after the estate is closed.

The Benefits and Drawbacks of Avoiding Probate

Before a decision to avoid probate is made, both the benefits and drawbacks of probate should be considered. Avoiding probate usually results in (1) lower expenses for disposition of the estate, (2) fewer complications regarding estate administration, (3) quicker disposition of the estate, and (4) public access to information concerning the estate. Avoiding probate can also result in lower taxes. However, avoiding probate is not without its drawbacks. Probate avoidance often involves lifetime gifts. A donor can later regret these lifetime transfers if he or she subsequently needs the income from those assets. In addition, completely avoiding probate can leave some assets undistributed. As a result, it is best for the individual to prepare a will unless he or she is willing to have the laws of the state to determine the disposition of the leftover assets. Finally, a plan for partial avoidance must be carefully integrated with the estate owner's will. This requires a substantial amount of advance planning. The costs of such advance planning can be significant and should be treated as part of the cost of partially avoiding probate.

Eight Common Ways Used to Avoid Probate

Listed below are eight common techniques used to avoid probate. Before implementing any of these arrangements, the estate owner must consider whether one of these techniques will fit into his or her overall estate plan.

1. Lifetime Gifts. Under this scenario the property owner transfers cash and property to designated heirs during his or her lifetime. For the transfer to be valid, the estate owner must relinquish control over the property and cannot recover it should the need arise. Prior to using this strategy, the gift tax, estate tax, generation-skipping tax and income tax consequences must be evaluated.

2. Bargain Sales During Life. This technique involves a sale of property by the estate owner, during his or her lifetime, for less than its fair market value. This strategy can produce complications concerning such matters as the basis for establishing gain or loss, as well as gift, estate, generation-skipping and income tax problems.

3. Sale of Property for a Private Annuity. When property is sold for a private annuity, the property owner transfers a specific asset (or assets) in exchange for an individual's promise to make a series of payments to the property owner over his or her life. This technique is not without complications. First, the gift, estate, generation-skipping and income tax consequences must be examined. Second, the willingness and ability of the payor to make the annuity payments must be determined. Finally, because the timing of death cannot be predicted, there is the possibility that the arrangement can result in an economic loss to one side or the other.

4. Establishing a Living Trust. A living trust is one technique that allows a property owner to distribute assets without using a will. Compared with wills, living trusts are more difficult to contest. Heirs are generally more successful in challenging and setting aside wills than trusts. In the case of a living trust, the specified assets are placed in trust to be distributed during the estate owner's life or after his or her death. A living trust can be either revocable or irrevocable. However, using a living trust does have drawbacks. First, drafting a living trust requires legal expertise which can be a significant expense. Second, the property owner must be willing to legally turn over ownership of the assets to the trust. Third, there are expenses associated with administering a living trust; these include the trustee's fee, annual bookkeeping and accounting expenses. Finally, a full scale accounting is usually necessary at the time of the trust settlor's death; and this can be as complicated and expensive as a probate proceeding.

5. Life Insurance with a Designated Beneficiary Other than the Estate. A life insurance death benefit is not subject to probate upon the insured's death, if a beneficiary other than the estate is named.

6. Joint Ownership with Right of Survivorship. Under this arrangement, property passes immediately upon the death of the first joint owner to die. This is a popular form of ownership for such items as a family house and the family checking account, for it enables a quick and certain transfer at death.

7. Designating a Beneficiary of Plan Benefits. This technique involves naming a beneficiary other than the plan participant's estate to receive proceeds from a self-employed individual's plan, an IRA, SEP, ESOP or tax deferred annuity. In this case the proceeds will bypass probate and be transferred directly to the named beneficiary. The primary drawback to using this plan are the unique estate, gift and income tax rules that can come into play. Also, if the proceeds are substantial, the named beneficiary can receive a "windfall" in comparison with amounts received by other family members.

8. Death Benefit Only Plans for Key Employees. This is a contractual arrangement under which the employer promises to pay a specified amount to one or more designated beneficiaries at the employee's death. Again, before using this technique, the estate owner must evaluate the estate, gift and income tax consequences. In addition, the employer must be willing to enter into this type of contractual arrangement.