CHAPTER 17

Non-Probate vs. Probate Assets – Why You Should Care

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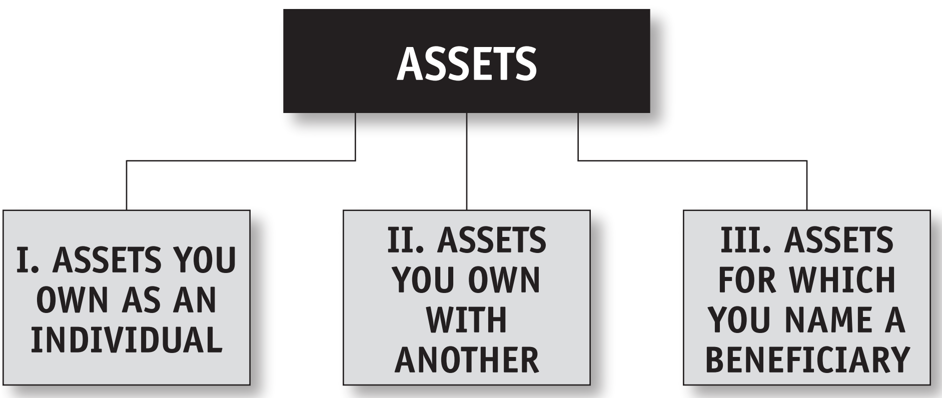
When you die, like most other people, you will probably leave assets that need to be transferred to the person, persons, or organizations (charitable or other) that you have named in your will or living trust. If you die without a will, your property will go to whomever your state's law says it will go.

An asset will be a probate asset if your state law requires the property to be administered under your state's probate process before it can be transferred to your beneficiaries after your death.

Assets fall into three categories: 1) property you own as an individual, 2) property you own with another, and 3) property for which you have named a beneficiary, such as a life insurance policy or a retirement plan.



I. ASSETS YOU OWN AS AN INDIVIDUAL

An asset you own as an individual at the time of your death (that does not otherwise avoid probate as described in Section III below) is a probate asset because the probate process in your state will require certain steps to be taken for individually held assets to be transferred to your heirs or beneficiaries.

II. ASSETS YOU OWN WITH ANOTHER

Usually, an asset you hold jointly with another individual or individuals will not be a probate asset. For example, assets such as a residence, bank account, or brokerage account you own as joint tenant with right of survivorship with your spouse are not probate assets because at your death the surviving joint owner — in this example, your spouse — gets title to the asset because of the survivorship feature of this type of ownership. However, an asset you hold with another person or persons could still be considered a probate asset. Let's say you and two friends invest in a piece of real property. In this case you own a one-third share of the property along with your two friends, each of whom also owns a one-third interest. In this case, the property is owned as tenants-in-common instead of jointly with right of survivorship as in the first example. At your death your one-third share is a probate asset because you are the sole owner of that one-third interest at the time of your death.

III. ASSETS FOR WHICH YOU NAME A BENEFICIARY

Generally, assets for which you name a beneficiary are not probate assets. Accordingly, the underlying assets of most life insurance policies, annuities, qualified retirement plans, individual retirement accounts, and accounts that provide for transfers on death pass directly to the named beneficiary by contract and need not pass through the probate process. But, what if the beneficiary named on your life insurance policy or retirement account is your estate? What if there is no named beneficiary, or the named beneficiary has predeceased you and you have failed to name a contingent beneficiary? When this occurs — and it often does — the asset is subject to the probate process, either because you purposely named your estate as the beneficiary, or your beneficiary designation lapsed, causing the assets by default to vest in your estate.

The probate system varies from state to state. While there are certainly situations where it is advisable to utilize the statutory probate process (for example, where the protections of the court system are necessary to guarantee the interest of beneficiaries and/or fiduciaries), in the overwhelming majority of circumstances probate is an unnecessary hassle. For years, advice has been rendered about how to avoid it. Even the simplest formal probate requires probate fees, inventories, and accountings. A complex scenario could drag on for years. In between these two extremes, the process entails numerous statutory requirements, meticulous record-keeping, precise attention to detail, and strict timetables, all resulting in unnecessary expense and time-consuming inconvenience. Witness a paraphrase of a letter recently sent by a probate official to an attorney acquaintance of this writer:

> *Dear Counsellor:*
>
> *Thank you for the final account for the referenced estate.*
>
> *Your total on the summary sheet for line 5 is $203,199.50, but the total for line 11 is $203,199.51 which is off by one cent.*
>
> *The will bequeaths numerous items to named individuals. You will need*

> *to show each of these items as distributions in the account; the signed receipts are insufficient.*
>
> *The receipt you sent for Section 3 says it was for a horse, but you had previously informed this office that the horse was dead. Should this receipt be for the dog instead of the horse?*
>
> *You also show $25,000.00 to each of five heirs in your disbursements, but these should be shown as distributions to beneficiaries.*
>
> *You show the distribution of the 1995 Toyota Corolla and the 1989 Dodge truck to the beneficiaries but state below this that the 1995 Toyota Corolla went to Donna Drake and the 1989 Dodge truck went to John Drake. If the two individuals mentioned received these vehicles then you do not show it also distributed to the beneficiaries.*
>
> *We will need the canceled check written to Somerset County on April 5, 2006 for $40.25; the receipt is not sufficient.*
>
> *Please redo the account and resubmit it to this office as soon as possible. Please consult our published fee schedule for the appropriate fee for resubmission.*
>
> *Sincerely,*
> *The Probate Department*

Not the letter your executor or your attorney wants to receive after everyone thinks the matter has been finalized.

What you should do: Consider using a revocable living trust as the controlling document distributing your assets at your death. Transfer individually held assets for which joint ownership or beneficiary designations are not options or not advisable (residence, interests in real estate, bank accounts, brokerage accounts, and your stuff — golf clubs, jewelry, pianos, cars, boats, household items, and maybe even horses — to you as Trustee of your trust by deed, re-registration, or affidavit of transfer. That way when you die, your successor trustee will have title to the assets and can distribute them according to the instructions contained in your revocable living trust and avoid probate of these assets. Remember if your joint co-owner of property predeceases you, you as the surviving joint owner, will be the sole owner and the property will be a probate asset. At the death of a co-owner, transfer the asset to your trust. Be sure to keep beneficiary designations on life insurance policies, annuities, and retirement plans up-to-date to avoid distribution by default to your estate. With advice of your tax advisor, accountant, and/or attorney you may wish to consider naming your revocable living trust as the beneficiary of these types of assets.

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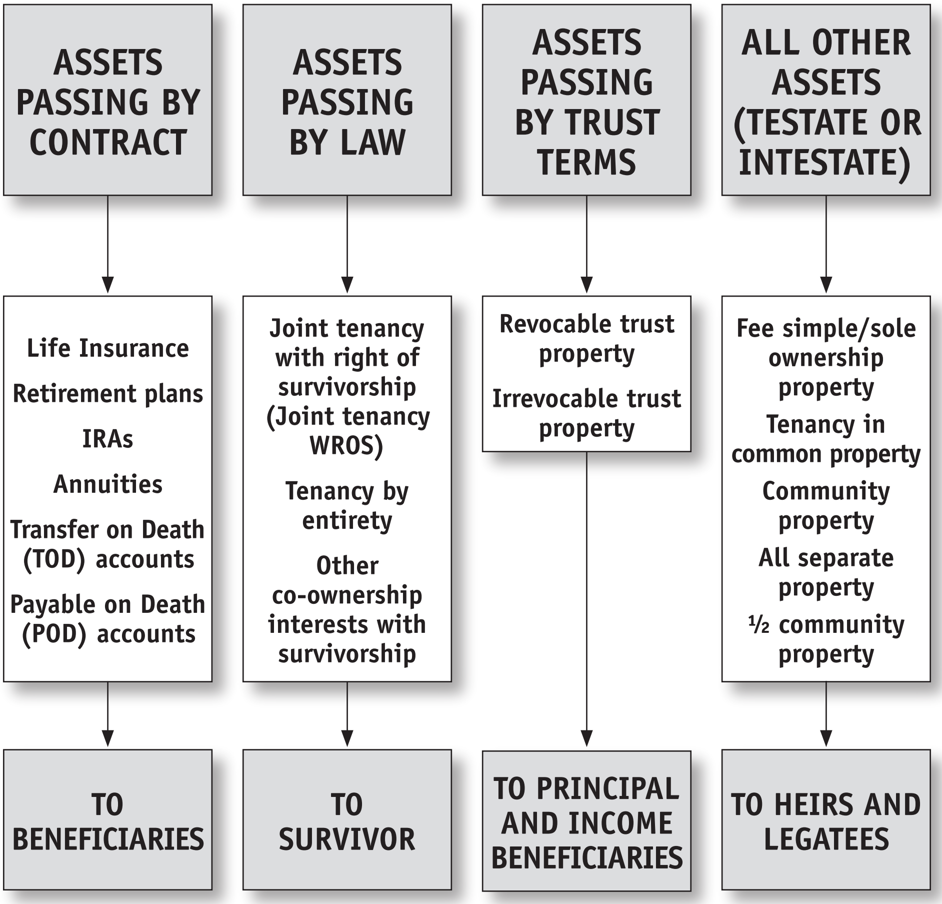
Probate and Non-Probate Assets



Will Substitutes Compared

	JOINT TENANCY WROS	REVOCABLE TRUST
What property is used?	Real or personal.	Real or personal.
How do you set it up?	Sign a document.	Attorney creates a trust document and owner re-titles assets to the trust.
How much does it cost?	Minimal cost.	Moderate cost.
What are the gift tax consequences?	Spouse — none. Nonspouse — may be a taxable gift.	None since no completed gift has been made.
What are the income tax consequences?	Income splitting between joint tenants.	Income is taxed to the grantor.
What are the estate tax consequences?	Spouses — 50% is included in the decedent's gross estate. Nonspouses — Entire value is included unless the survivor made contributions.	Entire value of trust assets is included in grantor's estate.
How much control does the owner retain?	Owner gives up control of property.	Owner/grantor can change trust at any time, thus retains control until incapacity or death.
Do assets avoid probate?	Yes, pass to survivor.	Yes, pass to income and principal beneficiaries.
Do the assets receive a step up in basis at death?	Spouses — Yes, ½ of property receives a step up in basis. (Note: Full step up in basis is for property held as community property in community property states.) Nonspouses — Yes, to the extent of inclusion in the decedent's estate.	Yes, 100% of property receives a step up in basis.
Will the assets qualify for the marital deduction?	Spouses — Yes, ½ of property qualifies. Nonspouses — No, none of the property qualifies.	Depends on the trust document.
Will the assets qualify for the unified credit?	Spouses — No, none of the property qualifies. Nonspouses — Yes, value included in decedent's gross estate qualifies.	Depends on the trust document.