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Worth It Episode 6: What Estate Planning Documents Does Every Client Need?

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In this episode of Worth It, Proskauer partner Stephanie Heilborn and associate Dan Hatten discuss the standard estate planning documents every client needs, what those documents do, and why those documents are important to have in place.

Dan Hatten: Hello and welcome to Worth It: a podcast brought to you by Proskauer's Private Client Services Group covering a wide range of topics concerning estate planning, wealth transfers, important legal developments and other issues our clients frequently face when organizing their estates. My name is Dan Hatten, an associate in Proskauer's New York office. In this episode, we'll be discussing the standard estate planning documents that every client needs, what those documents do and why those documents are important to have in place. Joining me for this episode is Stephanie Heilborn, partner at Proskauer's New York office. Welcome Stephanie.

Stephanie Heilborn: Thanks Dan. How are you?

Dan Hatten: I am doing great. So, thanks for joining today, Stephanie. I think the big picture is what are the basic estate planning documents that you usually discuss when you're meeting with a new client.

Stephanie Heilborn: So there are four documents that I'd like to cover today and those documents are: wills, revocable trusts, health care proxies and powers of attorney. And those documents do two things. First, they enable you to say where you want your property to go at death. And second, they allow you to name whom you want to be in charge of those decisions at death, and also in the case of your durable power of attorney and health care proxy during your lifetime in the case of incapacity.

Dan Hatten: So let's start with a will and a revocable trust. It makes sense to talk about these together. Can you tell us a little about what these two documents do?

Stephanie Heilborn: Sure, so each state's law has a default as to what happens on your death if you say nothing. And those default rules may not be what you want. And so for example, in New York, if you're married, and you have kids and you die without a will half your property will go to your spouse, and half will go to your kids. And for a variety of reasons, especially if your kids are minors that might not be what you want. So, in a will, you are opting out of those default rules, and you are saying where you want your property to go, and whom you want to be in charge. That's really important, especially if you are married and have a couple with young kids, because, generally you don't want assets passing outright to kids. That can also be a tax inefficient way of disposing of your assets, because normally, most people would want the assets to pass for the primary benefit of the surviving spouse and then to the kids. That's because that enables all of the estate tax to be deferred until the second death. And so the will is really important so that you can opt out of those default rules and have the most tax efficient disposition, and also put in charge the people that you want to put in charge, including, for example, a guardian for your minor children.

Dan Hatten: And so that's the will and sometimes I know I talked about it in terms of a revocable trust also. Can you talk a little about how those two work together?

Stephanie Heilborn: Sure, so in most states, the process of getting a will admitted to probate, which is the fancy term for getting an executor appointed, is a formal process. And there's a good reason for that, and that's because we don't want people to come in with fake wills and say here, this is that person's will. In New York, for example, to get a will admitted to probate, all of the heirs need to get notified. There's a formal petition and so that's the court overseen process. Over I would say, the past 10 to 20 years, because of a variety of factors, the courts have gotten more overburdened, it's not their fault, it just is what it is. And so that probate process is more time consuming and probably expensive than it used to be. Even if you have a perfectly drafted will, there's still a time and cost factor in getting that will admitted to probate. The way to minimize that time and cost is to have something that goes along with your will called a revocable trust. So the way that I always like to describe those documents is that they work in tandem; it's almost like a book with two chapters. Chapter One is your will and it says this is whom I appoint as my executor and this is whom I appoint as my guardian, and then look at my revocable trust to see exactly how you want the assets disposed of. The advantage of doing it that way, is that if you actually fund or transfer assets into your revocable trust during your lifetime, those assets actually, don't pass through that probate process. And so it minimizes the time and the cost associated with transferring assets upon somebody's death because you have the last-word oversight.

Dan Hatten: And are there future benefits in addition to those immediate benefits of using a revocable trust?

Stephanie Heilborn: Yeah, so this is also a kind of technical point which a lot of people don't realize. If you create a Trust for the benefit of your spouse or descendants, under a will, at least in New York and it's the same way in a lot of other states, future changes in trustees and other proceedings related to that Trust are always subject to court approval. On the other hand, you create that trust, under a revocable Trust, then that's not subject to court approval in the future, and so you also not only get out of court oversight of your probate process, you also get out of a lot of court oversight, not all of it, but a lot of court oversight of future changes in trustees under it.

Dan Hatten: Is there any kind of property that doesn't pass under a will that you have to account for also?

Stephanie Heilborn: Yeah, so this is a great question because a lot -- especially a lot of spouses -- come in and say, well, why can't we just own all our assets jointly? Then it's easy. We avoid probate, and then everything passes outright to my surviving spouse. That can be a good thing for specific kinds of assets -- usually your primary marital residence -- but there are a couple of problems with that. First of all, it can be tax inefficient, and that has to do with the structure of the estate tax exemption which is not a discussion we're going to have today. But the other thing is that it also doesn't preclude your surviving spouse from then leaving all of those assets to his or her next spouse, and so that's what I would say most people don't want to have happen, so joint ownership is not a solution to this. Second, there are other categories of assets such as life insurance and retirement benefits, which we'll get to, that don't pass under a will. Those are called non-probate assets, and they typically pass by something called a beneficiary designation. So while the will and revocable trusts are really important for disposing of most of your assets, many people have a significant component of their estate that's composed of things like 401Ks, IRAs, life insurance, and those are often dealt with separately.

Dan Hatten: Got it. So that's the will and a revocable trust and those things happen at death. You also mentioned the decisions that can be made during life. Can you talk about those documents: the healthcare proxy and the power of attorney?

Stephanie Heilborn: Yeah, so estate planning is not only about what happens on death. It also is about what happens in the case of your incapacity and especially these days when people are living so much longer. What I honestly worry about for myself is that there could be a long period at the end of my life when I'm alive but I don't have capacity to manage my own assets. And so part of the estate planning process is setting up a mechanism to enable clients to appoint the appropriate people to manage assets and make decisions in the case of incapacity. So a power of attorney is a financial document, and that's where you can name one or more people to make financial decisions for you if you're incapacitated. A really important point is that at least in New York, a power of attorney can also operate even if you have capacity. So lots of spouses or even people who aren't married will execute powers of attorneys to name people to make financial decisions for them if they're unavailable. It happens all the time. You might be traveling or out of the country, you need a tax return filed, you're closing on a house. And so a power of attorney can enable somebody to make those decisions for you, but it survives through your incapacity. So if you later become incapacitated, the people that you named still have the power to manage your assets for you and that's really important because it avoids a guardianship or conservatorship proceeding, and the name of the game is you do not want the court making the decision about who’s going to manage your assets if you don't have capacity.

Dan Hatten: Can a healthcare proxy help a client who might be incapacitated with those decisions?

Stephanie Heilborn: So a Healthcare proxy only operates if you can't consent to your own treatment. Lots of people ask about healthcare proxies because they're worried that if they name somebody as their healthcare agent and then they just end up in the hospital temporarily, then all of a sudden this person is going to be making decisions for them and that's not the case. As long as you can tell a doctor yes or no, the healthcare proxy doesn't matter. It's only when you are unable to consent to your own treatment. There have been a lot of awful and well publicized cases over the years about people who didn't have Healthcare Proxies in place and unfortunately the family members were fighting about what should happened to them and they were fighting with the health care facilities about whether the person should be taken off life support or not. The truth is those cases are incredibly rare but again going back to the principle of opting out of the default. You always want to make that decision. And I would say the vast majority of clients feel very strongly about naming the appropriate person to make those decisions, if they can't, and also setting forth decision-making guidelines about how to make those decisions. A healthcare proxy is where you can say, either, don't keep me alive, under unusual circumstances, I don't want to live on a ventilator for years. Alternatively, if you're the kind of person who wants to be kept alive at all costs, you can say that in your healthcare proxy, and so the point of that document is not only to name the person who will make that decision but also give them guidelines for decision making.

Dan Hatten: So those are the documents I think both of us always talk about with new clients. Are there any documents you frequently discuss to address other kinds of property? You mentioned beneficiary designations and life insurance. Maybe that could be a topic we could talk about with a lot of clients as well.

Stephanie Heilborn: Yes, so as I said, life insurance can be an important component of the estate plan for a couple of reasons. First of all, a lot of clients especially when they are younger -- they have minor children -- will buy life insurance as so called “income replacement” because what clients are trying to do is ensure that if God forbid one of those spouses die prematurely there is a pot of money available for the surviving spouse and the kids. And that’s because the couple will have lost the benefit of that person’s income, because they died prematurely. So that is important because everybody knows the rule, and most people know the rule that the beneficiary takes the proceeds of the policy income tax free. That’s easy. There’s a separate rule that says that if you own a policy of insurance on your own life and you retain all the rights to designate who the beneficiary is, and choose investment options, the death benefit is included in your estate for estate tax purposes. So, for example, if you’ve got a policy that pays out $5 million dollars on death all of a sudden that $5 million dollars can be included in your taxable estate which can be a big deal because you could be giving up 50% of the death benefit over and above an exemption amount, and nobody wants that. The way to avoid that is to have the policy owned in a separate trust called a life insurance trust. So that’s why we always strongly recommend that clients purchase those life insurance policies through a trust that will avoid the taxation of the death benefit on the death of the first spouse, so the surviving spouse and the kids have a tax-free pot of money available to them.

Dan Hatten: Is there anything you want to mention about retirement benefits planning as well?

Stephanie Heilborn: Sure. Remember: those assets are also non-probate assets meaning they pass by beneficiary designation, and so if there's one thing that you take away from this podcast and that you should do as soon as you take off your headphones, you actually should check your beneficiary designations, because I would say that is the one thing people tend not to update for years, and so I've had clients walk into my office who have been married for 10 years, but the brother is still the designated beneficiary on their IRA because they never changed it, and so it is really important to update those beneficiaries designations. I would say for the most part most people end up naming the surviving spouse as the outright beneficiary in those retirement accounts. That can be income tax efficient. But as I said, since those assets don't pass under the will and revocable trust, you need to make sure that your beneficiaries have been updated so that they reflect your wishes.

Dan Hatten: That's all very helpful. Thanks for coming on Worth It and discussing the estate-planning documents that every client needs, the documents and every client should consider putting in place or revising. Clients, of course, need a will and in many cases a revocable trust to dispose of assets at death. A power of attorney and health care proxy are also important to help enable agents to make financial and health care decisions if the client is incapacitated and, in some cases, to help with decisions if the client is just not available. And additionally, whenever a client revises his or her estate plan, it sounds like they should also consider what they're doing with their life insurance. Consider updating their beneficiary designations on retirement accounts, 401Ks, annuities and similar assets. So thanks again, Stephanie, for talking us through this.

Stephanie Heilborn: You're welcome, nice to be here.

Dan Hatten: And with that we will wrap up this episode of Worth It. We hope you enjoyed this podcast, and please join us for future episodes. If you would like to receive notifications of when new episodes are available, please visit our website Proskauer.com, where you can subscribe to our publications link at the bottom of the page. Thank you.

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