Methods of transferring your property

Wills

Wills serve many useful estate planning functions. If you die intestate (without a will), your property will be distributed as provided by state law and administered by someone appointed by the court. If you have minor children, the court will decide who will care for them. Wills permit you to specify how you want your property distributed and to designate your choices for the guardian of your minor children and the person who will handle the distribution of your property. A will may also contain provisions to minimize estate taxes, reduce administrative expenses, and provide for management of investments or a business until they are distributed. Using a will as your primary estate planning document will not avoid probate, but it will ensure that your wishes for disposition of your property are followed. Even if you have revocable or living trust as your primary estate planning document, you will need a simple will to dispose of personal property and to transfer to your trust any property you did not contribute to the trust during your lifetime. Wills are solely a method of transferring property on death and provide no help if you become incapacitated and unable to manage your assets while you are still alive.

Joint ownership of property

Many people use joint ownership with their spouse or their children as their estate plan. Using joint ownership as your estate plan has some advantages, but it also has some serious disadvantages and risks. Because of the serious drawbacks to joint ownership, it should not be used as your primary method to transfer your property upon death.

Joint ownership of property with a spouse is a low cost and convenient estate plan. It is an estate plan that can be accomplished without the services of an attorney, except as may be necessary to prepare deeds for real property. Joint ownership insures the surviving spouse receives all the property on the first death. It also avoids probate and estate taxes on the first spouse's death. There is no requirement for probate because all the property automatically passes to the surviving spouse without the need for the approval of a probate court. No estate taxes are payable because all the property passes to the surviving spouse under the unlimited estate tax marital deduction.

Joint ownership with a spouse only postpones probate until the second death. When the surviving joint owner dies, all the property he or she owns will be subject to probate unless the survivor has done estate planning to avoid probate. Joint ownership also offers no protection from conservatorship proceedings caused by the incapacity of one of the joint owners. The signature of both owners is needed to sell or transfer jointly owned real property. If one owner is incapacitated, nothing can be done with jointly owned real property until a conservator or guardian is appointed by the probate court to act for the incapacitated person or unless a valid power of attorney is in effect. Conservatorship proceedings, with the associated attorney fees and court costs, will continue until the incapacitated joint owner dies or recovers.

Joint ownership provides limited federal estate tax planning. Through the use of the concept of portability, the surviving spouse can elect to preserve the first to die’s unused exclusion amount. If a portability election is made at the first death, the surviving spouse will have his or her exclusion amount plus the deceased spouse’s unused exclusion amount to use to avoid gift tax on lifetime gifts or to avoid estate tax on the second death.

With portability, an estate tax will not be due on the second death unless the value of the survivor's estate exceeds the survivor's remaining exclusion amount plus the amount of the first-to-die's unused exclusion amount the survivor carried forward with the portability election. The portability election may also have an income tax impact. If portability is elected, all the couple's property will be included in the estate of the survivor and it all will receive an income tax basis step-up in value on the second death. If portability is not elected only one-half of joint property will be included in the taxable estate of the survivor and receive an income tax step-up in value at the second death. The other one-half received a step up on the first death and does not get another step up on the second death. That may mean that the children or other beneficiaries on the second death will have more taxable gain on the sale of the property they inherit. Portability is explained in more detail under the Practice Area, Tax Planning, General Information, 2012 Taxpayer Relief Act of this website.

The first-to-die loses control over property which he or she owns jointly with a spouse at the time of death. The heirs of the last to die will receive all of the property and the heirs of the first-to-die receive nothing. This may not be a problem where the heirs of both spouses are the same. However, this can be a particularly disturbing result in a second marriage where the surviving spouse is free to give all the property to his or her children and exclude the children of the first-to-die. It can also be a problem when the surviving spouse remarries and leaves all the property to his or her new spouse.

Owning property jointly with your children can be a disaster. Although owning property jointly with your children may avoid probate, it creates many problems. First, if you own property jointly with your child, your property will be subject to the claims of the child's creditors and the claims of the child's divorcing spouse. Second, if you transfer real estate into joint ownership with your children, you will be making a taxable gift to them that will use part of your applicable exclusion amount. Third, owning property jointly with a child does not avoid estate taxes and may cause part of the property to be included in the estate of the child if the child dies first. If the child dies first, you will have to prove you provided all of the money for the purchase and upkeep of the property to avoid it being included in the child's estate. Finally, when you own property jointly with your children, you give up control over how and when the children receive the property. They will be given complete control over the property at your death regardless of their ability to handle the property. If the child is a minor or disabled, a guardian or conservator must be appointed for the child. If you put property into joint ownership with one child with the understanding that child will share the property with the other children, you have no assurance your plan will be carried out. Further, if the child does divide the property among his or her siblings, he or she will be making taxable gifts to them.

Beneficiary designations

Proper beneficiary designations for life insurance, annuities, IRAs, pension plans, and investment accounts are essential for a complete estate plan. Property transferred by beneficiary designation is not subject to probate. However, using beneficiary designations to transfer property does not avoid estate taxes. Also, as with joint ownership, the first to die loses control over property which he or she gives to the surviving spouse by beneficiary designation. The surviving spouse chooses who will receive the property on his or her death and the heirs of the first spouse to die may receive nothing. If your spouse is designated the beneficiary of all your assets, there will be no estate tax due upon the first death. However, if you leave everything to your spouse by beneficiary designations, and you fail to make a portability election, you will waste the applicable exclusion amount of the first to die and only defer estate taxes until the second death. Beneficiary designations can be integrated into the estate plan of a will or revocable trust by designating a trust included in the will or the revocable trust as beneficiary. Because of income tax advantages of rollovers and continued income deferral, it is usually the best choice to designate the surviving spouse as the first beneficiary of IRAs and pension plans. Choosing the right second beneficiary for IRAs and pension plans requires a thorough analysis of both the income and estate tax implications of the available choices. Beneficiary designations only take effect at death and give the beneficiary no ability to use the assets for your benefit during a period of incapacity.