

## WHEN IS A GOOD WILL NOT GOOD ENOUGH?

You may think that an estate plan consists of having a will. A good will is an important part of a good estate plan, but it is often not good enough.

### What does a will cover?

A will transfers assets of every kind if the assets are titled in your name alone or owned by you alone AND the assets do not have a beneficiary designation. The fact is that a will does not transfer many types of assets. As a result, what you have said in your will may have no effect.

### What does a will NOT cover?

Your will ordinarily does not transfer or affect the following kinds of property:

**Joint Tenancy.** Joint tenancy assets pass to the other joint tenant immediately at your death. Your first reaction is, “That is OK.” But consider:

- The possibility that you are with the other joint tenant in a common disaster. If you die first (even by a few seconds) your joint tenancy assets pass under the will of the other person and not under your will. That *may* be fine for many people; but often the primary owner prefers to control the passage of the assets in that situation.
- The possibility that the other joint tenant files bankruptcy or is involved in a divorce. Your jointly owned assets may be in jeopardy.
- **Bank Accounts set up with two names.** Bank accounts with two names are almost always joint tenancy accounts unless you have specified differently when you set up the account. If you want to have another person sign for you in the event of an emergency, you can often designate that other person as an accommodation signer. However, most people have not made this arrangement with their bank. In that case, the other person on the account becomes the owner immediately on your death. (See issues raised in previous paragraph.)
- **Pay on Death and Transfer on Death. These designations** are often made on securities held in accounts with brokers. The result is very much the same as joint tenancy. The property passes immediately on your death to the person that you have designated.
- **Investment Instruments that have beneficiary designations.** The common examples of assets with beneficiary designations are:
  - + Life insurance policies
  - +Annuity products
  - +Individual Retirement Accounts
  - +Roth IRA’s
  - +401(a) Plans
  - +401(k) Plans
  - +403(b) Plans

Each of these is a contract that you, as the owner, has with the insurance company or the pension plan administrator. That contract says that on the your death, the administrator or insurer agrees to pay the death benefits to the person designated by you before death. Consequently, *the provisions of your will do not come into play* in saying where the proceeds will be paid.

### **Why are the provisions of your will important for your estate plan?**

Recall that your will covers more than just the question of who is to receive your property. A well drafted will:

Nominates an executor who will deal with the property after your death and before it is distributed to your beneficiaries.

- Provides for paying taxes that come due after your death. These may be income taxes or death taxes. The question usually addressed in a will is: “Who will pay those taxes?” Will the taxes on specific assets be paid by the person who receives the property or by someone who does not receive the property?
- States an age at which minor persons may receive the property after your death. Under Iowa law, a minor person will receive the property outright when reaching age 18. With a will, that can be delayed until age 21 or any other age that you specify.
- Explains how to treat the situation if you and the beneficiary die in a common disaster. In that case, you may want someone else to receive your property. It also could determine whether you can take advantage of the death tax marital deduction.
- Explains how you treat the situation where one of your children does not survive you, whether the child is deceased at the time that you sign the will or dies after you sign, even in the same accident that takes your life. Generally, the choices are that the deceased child’s descendants take the deceased child’s share OR the share is divided among your other children.
- Explains how your assets will be owned after your death during the life of your surviving spouse (who may have been injured in the same accident that took your life) or during the lives of your children (who may not be good at handling money or who may have spouses or a parent that you would not want to handle the assets). A will often provides for a trust to be used in these situations.
- Assures that issues arising during probate of your estate will be decided under Iowa law.

Once you have provided for these and other issues in your will you may think that your estate plan is complete. However, where beneficiary designations are involved, your will is

usually not involved.

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**With beneficiary designations, the rules are different than the rules in your will.**

It is often said, “Without a will, the state decides how your property will be distributed.” However if you have not carefully prepared your beneficiary designations, the contract with the provider decides how the death benefits will be distributed. The results will not be as you expected.

- None of the important provisions of your will applies to distribution of death benefits.
- Each beneficiary deals directly with the provider, and there may be little coordination or cooperation with the executor of your will. If the beneficiary is a minor or is disabled, a person not of your choosing will act for that minor person.
- Most of the contractual arrangements (insurance products and pension plans) have their own tax effects. Some of them are subject to death taxes, and most of them are also subject to income tax. That gives rise to two potential situations:
  - 1) Unless you provide otherwise, Iowa law says that death taxes will be paid out of the will assets. For instance, if the IRA assets far exceed the will assets, the death taxes may consume the will assets with no practical way of collecting back from the beneficiary of the IRA.
  - 2) The income taxes are paid by the designated beneficiaries. If the beneficiary designation is worded in a certain way, those taxes can be spread over a lifetime while the assets continue to appreciate. Otherwise, the income taxes may be payable almost immediately on your death thus costing as much as 40 to 50 percent of the planned death benefit.

In either event, the amount that your beneficiaries receive may be substantially different than what you anticipated if you do not carefully consider these issues and properly prepare your beneficiary designations.

- Unless there is provision in your beneficiary designation about the age that the beneficiaries must be, large sums of money may come into the hands of people as young as 18 years of age.
- If your beneficiary designation does not address what happens in a common disaster with your beneficiary, the death proceeds may pass to the beneficiary's spouse or family rather than to the people you would choose.
- If your beneficiary dies before you, most beneficiary designation forms give that person's share to the others listed on the form rather than to the deceased beneficiary's children. You may prefer that the children of the deceased beneficiary receive the assets; and your will probably provides for that. But your

will have no effect as to those assets. You may have set up a trust for the benefit of your spouse or descendants or both. If you decide to name the trust as beneficiary of the contract assets, there are many considerations that require special knowledge. Unless you have that knowledge or consult with someone who does, the wording on your designation form will likely have unexpected and unfavorable tax and other economic effects.

- Unless you specify otherwise in your beneficiary designation, the law of the pension plan provider will likely be used in the case of a conflict of laws. That is usually not to your advantage. Usually Iowa law would be to your advantage when the rest of your estate plan is based on Iowa law.
- If you have several beneficiaries of your pension plans, the length of time over which they receive payments from your plan will ordinarily be the life expectancy of the oldest beneficiary. If one beneficiary is substantially younger than the other, the younger one would be much better off financially if the payout of death benefits could be over that person's own life expectancy rather than the life expectancy someone much older. A carefully drawn beneficiary designation will allow that.
- Likewise, complicated rules allow a younger spouse to withdraw from the death proceeds over a much longer period, if the proceeds are payable to the spouse rather than to a trust. Yet, you may prefer that a trust be the beneficiary if you want to preserve assets for your children when your spouse is gone. Without careful consideration of this issue, you are certain to make an uninformed choice almost always resulting in great expense.
- A beneficiary may want to have an investment manager handle the investments within the IRA. Unless the IRA provider is so directed in the beneficiary designation, the beneficiary may be powerless to enable a manager to assist.

### **What should you do to protect your assets and preserve your estate plan?**

If any of these issues concern you, you should

- Review the beneficiary designations on all your pension type assets and insurance products.
- Be alert to the issues raised so that you know to ask the proper questions when preparing beneficiary designation forms.
- Seek competent counsel in preparing your designations.

**If you have gone to the effort and expense to have a good will, make sure that you follow through and have a good estate plan from top to bottom.**