AMERICAN GENERAL LIFE COMPANIES

Top 10 Wealth Transfer Mistakes

1. Too Much Joint Property

It has been said that a "simple solution" to the transfer of wealth was to have it all titled in joint name. This "simple solution" can cost hundreds and result in costly tax and non-tax problems when used excessively or by the wrong people.

At death, your property essentially will pass one of three ways: by title, by beneficiary designation or by your will. Joint property passes by title, meaning that it overrides your will. A surviving spouse can do whatever they want with the previously jointly owned property during life and ultimately leave it to anyone they wish at death, regardless of your desires. This can be a significant issue in second marriages.

When property is titled jointly, it does not escape taxation. In fact, when the transfer is made to someone other than a spouse, there is the potential to trigger gift taxes. Remember that the federal tax rates are called the Unified Gift and Estate Tax rates. That means that the taxes apply whether you transfer property while you're living or after you're gone. Gift transfers in excess of the Lifetime Exemption, $1,000,000 in 2009, are taxed at rates beginning at 18 percent and escalate to a top rate of 45 percent.

Although the Lifetime Exemption, or Unified Credit, allows every individual to effectively transfer a certain amount of wealth free of federal estate taxes, too much jointly owned property will override this exemption. This mistake can cost over $345,000 at 2009 rates in unnecessary taxes. (For additional detail, see No. 2.) You need to review your property ownership today.

2. Leaving Everything to Your Spouse

Some people erroneously believe that this eliminates federal estate taxes due to the estate tax Unlimited Marital Deduction. Keep in mind, however, that this is merely a postponement of tax. It's true that there is no tax at the first death, but at the second death, your assets will be piled on top of your spouse's assets and taxed at the highest rate. As noted previously, you can save over $345,000 at 2009 rates by establishing a trust at your death that will receive assets equal to your Lifetime Exemption. This trust, commonly called a Credit Shelter or Bypass Trust, provides income, and principal if needed, to them spouse for life, but is not included in the spouse's taxable estate after the spouse is gone.

The other issue here is a practical one: do they have the experience, or desire, to manage a large stock portfolio, real estate holdings or a family business? Ever worry that your hard-earned family wealth could end up in the hands of Mr. or Mrs. Now-That-You're-Gone, or their kids, and not ever make it to your children? You should consider a Beyond-The-Grave trust, called a Qualified Terminable Interest Property trust (QTIP for those who love acronyms). It would receive the property in excess of your Lifetime Exemption. It would pay income, and principal as needed, to your spouse for life, then transfer to the predetermined people of your choice, (e.g., your children).

3. Your Will is Not Your Will

A will is a legal document used by many to make their final wishes known: their wishes about who gets what they have after they're gone. One man's will said, "To my son I leave the pleasure of earning a living. For 28 years he thought that pleasure was mine, but he was mistaken."

John Harvard, in his will, left his personal library and half of his estate to build a new college on one acre of ground, a cow yard. One of the most sought after prizes in the world was established by the will of the inventor of dynamite and nitroglycerin: Alfred Nobel. Cecil Rhodes, through his will, created the now famous scholarships that bear his name.

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And yet, many die without a will in place. James Dean died at the age of 29 in a tragic car crash without a will. Not a surprise, but so did presidents Abraham Lincoln, Andrew Jackson, Ulysses Grant and James Garfield. Considered by some to have been the world's leading expert on wills, Thomas Jarman, died without one.

At least I have one, you may say. But, when did you last take a look at it? Do you know what it says? More importantly, does it reflect your current wishes? I can't tell you how many people, after we have completed our Plain English Review, are surprised to actually find out that their wills are not in line with their wishes. Major changes in your life should trigger a review.
And, you want to be sure that your will incorporates the latest tax law changes. Has your will been reviewed in light of ongoing tax law changes? Second, consider another opinion. Most would not consider major surgery without a second opinion. Protecting your wealth deserves the same attention.

4. Improperly Owned Life Insurance

Who owns your life insurance? If the answer is you or your spouse, it could cost you up to 45 cents of every dollar of benefit. Owning the policy means that the proceeds are included in your taxable estate. No problem at your death if you're married, but up to 45 percent can be lost unnecessarily at the death of the surviving spouse. You can establish a trust that will pay income and principal to your spouse as long as they live, but not be taxed when they are gone. Don't forget about your group term insurance, unless you take steps to remove it from your taxable estate, it will also be included.

We've seen the wrong contingent owner result in unnecessary taxes. And, making the estate the beneficiary will subject the proceeds to the claims of creditors, unnecessary delays of probate, and in some states, state inheritance tax.

5. Equating Success in Wealth Accumulation with Success in Wealth Transfer

J.P. Morgan built the family fortunes into a colossal financial and industrial empire and formed the U.S. Steel Corp., the first billion-dollar corporation in the world. He also financed manufacturing and mining, and controlled banks, insurance companies, shipping lines and communications systems. A brilliant businessman, yet he lost 69 percent, over $12,000,000, to taxes and costs at his death.

It is reported that the Probate Court form filed on July 30, 1990 by Daniel M. Galbreath, as Executor for John Galbreath, shows almost $20,000,000 or 65 percent, of his total wealth lost to Ohio and federal estate taxes. And the list goes on and on: John Rockefeller, Sr.; Alwin Ernst, CPA; Frederick Vanderbilt; and William Boeing all lost over 50 percent of their family wealth to estate taxes and costs. Since it's inception in 1913, the estate tax has too often succeeded in doing what it was instituted to do: to keep wealth from being transferred from one generation to the next. Just because you have accumulated wealth doesn't necessarily mean that you'll be able to transfer the majority of it.

6. Leaving Your Retirement Plans to Your Children

Retirement plan assets, when left to children, are subject to both the estate tax and an income tax called the Income in Respect of Decedent tax. What does that mean? Without proper planning, up to 60 percent of your retirement plan assets can be lost to taxes. Who's the beneficiary of the bulk of your IRA, the IRS?

7. Lack of Liquidity

In the 1800s, George Sand remarked, "to have no cash means, absolute powerlessness." In wealth transfer planning, no cash can be devastating. Particularly if your family wealth includes large real estate holdings or a business. Estate taxes can mean the loss of treasured family assets. Ask Joe Robbie's family: they lost the Miami Dolphins and Joe Robbie Stadium due to the need for cash to pay

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estate taxes. In a recent survey among successors of successful family businesses whose businesses failed after they were passed on to the next generation, 97.9 percent had to sell the business to raise the cash to pay estate taxes.

Estate taxes must be paid in cash, usually within nine months, after you are gone. Most people do not structure their wealth with liquidity in mind. Therefore, assets have to be liquidated, regardless of whether it's a good time to sell. A forced sale of an asset can result in not only the loss of the asset, but also a significant loss in value to your family due to the poor timing. In addition to federal estate taxes, the following can increase your family's need for cash: state death taxes, generation skipping transfer taxes, federal income taxes, state income taxes, probate and administrative costs, debts, cash bequests, family cash needs, family business cash needs and any funds needed to complete the transfer of a family business.

8. Equally Inequitable

This often happens in an attempt to make distributions to heirs equal. However, "equal" is not always "equitable." This is particularly true in a family business. Leaving control of the family business equally among siblings is a sure-fire recipe for business failure. Control, for decision making purposes, can be placed in the hands of the most qualified heir; while value, the worth of the business, can be shared equally by all heirs.

9. Believing That Everyone Must Pay Taxes

Transfer taxes are voluntary! "The fact that any substantial amount of tax is now being collected can only be attributed to taxpayer indifference to avoidance opportunities or a lack of aggressiveness on the part of estate planners." That was written by Columbia law professor, George Cooper, in his book, A Voluntary Tax? For a century, families like the DuPonts, the Kennedys and the Fords have passed large sums of money without taxes, through means available to us all. John Rockefeller, Jr., at his death, lost only 16 percent to taxes and his son avoided estate taxes altogether.

It is the right of every American to do whatever they can to avoid taxes. Judge Learned Hand wrote, "Anyone may so arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." If your current plan has you paying taxes when you're gone, you have not explored all your options.

10. No Integrated Game Plan

"The good is the enemy of the best!" Or, as Goethe said, "Things which matter most must never be at the mercy of things which matter least." What's this have to do with planning the transfer of your wealth? Everything. It's about priorities, about making the right decisions, about choosing the "best" course of action. But how do you do that, you ask. By beginning with, as Steven Covey puts it, the end in mind.

Think about the construction of a house. You begin with what kind of house you want, a clear picture of what it should look like. Then plans are formulated, a blueprint is prepared. All of this is done before one board is cut or one nail is driven. And, someone is put in charge of seeing that the project stays on track.

You wouldn't just begin building one room here, and one room there, hoping that it all fits together. And yet, that's the process that many are forced to use when it comes to the transfer of their wealth: one document here, one trust there. No integrated game plan, no sense of what it should look like when it's done, no coordination, no one responsible for keeping it all on track. The results are often disastrous: extra costs, too much in taxes, details not completed and missed leveraging opportunities.

(With permission, this article is adopted and updated from an article originally published by Physiciansnews.com.)

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