INTRODUCTION TO ESTATE PLANNING[1]

1. **Estate Planning: Its Goals and Objectives.**

a. What is "Estate Planning"? Estate planning is the process of planning for the orderly distribution of a person's assets at death to the persons the client desires to inherit such property. With a good estate plan, the property will pass in the manner desired by the owner with the least possible cost and delay. In addition, a good estate plan anticipates periods of incapacity that might be suffered by the person and puts into place mechanisms by which the person's assets and other business can be handled during such periods. This estate planning process entails meeting with the client to determine the client's desires, formulating a plan to accomplish those desires, drafting the necessary legal documents and then ensuring that the client's assets are owned properly and beneficiaries designated properly to accomplish the goals of the plan. For clients of the Duke Legal Project, the legal documents necessary to accomplish such a plan usually will include some or all of the following:

i. Advance Directive for a Natural Death ("Living Will").
ii. Durable power of attorney.
iii. Health Care Power of Attorney.
iv. Last Will and Testament.

b. Goals and Objectives. The following are among the goals and objectives of a properly thought out estate plan:

i. Provide security for surviving spouse, significant other or other third parties such as partners, elderly parents, minor children and disabled children.

ii. Provide for appropriate management of assets.

iii. Nominate guardians or trustees for minor children.

iv. Appoint an attorney-in-fact to handle assets in case of disability of principal.

v. Select a personal representative of estate.

vi. Provide an orderly method of paying expenses of estate administration,

[1] These materials have been adapted from manuscripts by Ronald P. Johnson of Nichols, Caffrey, Hill & Evans, L.L.P., and Barbara C. Ruby of Smith Helms Mulliss & Moore, L.L.P. and published by the North Carolina Bar Foundation.

taxes and debts.

vii. Make arrangements for specific property to pass to specific people.

viii. Minimize the probate estate and related probate expenses.

ix. Provide for certain charitable bequests and charitable beneficiaries.

x. Make provisions to keep a closely held business in the family.

xi. Minimize estate and inheritance taxes on death.

xii. Direct the disposition of remains.

xiii. Provide peace of mind to testator that affairs are in order.

c. Information Gathering. An essential aspect to successful estate planning is gathering accurate and complete information relating to the individuals involved and the assets which they own or have a power to dispose of at death. Once in hand, the information will prove invaluable upon the client's subsequent death, during the ongoing administration of the estate and the continuance of any trusts that might be established as a part of the estate plan.

The Health Justice Clinic has developed specific intake sheets to be used to gather the necessary information needed to effect a comprehensive estate plan for our clients. For wills, we use the Will Questionnaire and Family Information Form. These are used by the student during in an in-person interview, with the student asking the questions and filling in the answers. We do not send this to clients to ask them to fill it in. When there is time, however, we do send the client a list of items to bring when he or she comes for the interview, as well as the brief explanation of a will.

We begin by getting information about the client's family on the Family Information Form. Then we turn to the Wills Questionnaire, which gathers information about themselves, their family members and their property. It then asks about how the client wants the property to pass after his or her death. Although our clients generally have small, uncomplicated estates, it is very important to ask each question on the form to assure that we have all the information we need to carry out an effective estate plan and properly draft the necessary documents.

d. The Need for a Will. A will is a legally enforceable declaration of how a person wants his or her property to be distributed at death. A will is a blueprint that

guides the executor in handling an estate. A will allows a person to decide who will receive his or her property at death and what share each such person will receive. There are numerous reasons why it is important that each person execute a will as part of his or her estate plan.

i. Ability to Transfer Assets to the Chosen Beneficiaries. In the absence of a will, the Intestate Succession Act (N.C.G.S. Sec. 29-1 et seq.) will control disposition of the probate estate. While the statutory provisions are intended to provide a fair disposition of assets, the intestacy distribution often does not reflect the desires of the client.

ii. Ability to Designate a Guardian of the Person for Minor. If the client has a minor child, one of the most important reasons to execute a will is to designate the person to have the care and custody of the minor upon the deaths of the child's natural guardians. The inclusion of the preferred guardian in the will does not, in and of itself, appoint the named person as the guardian. The appointment is made by the Clerk of Superior Court in the county in which the child resides. Nevertheless, N.C.G.S. Sec. 35A-1225(d) provides that the Clerk of Superior Court is to use the designation in a parent's last will as a "strong guide" as to whom to appoint as guardian.

If a person dies without a will designating a guardian, the Clerk's discretion is unguided. Most clients have images of disliked relatives or in-laws rearing their child and can thus be convinced of the importance of a will to designate a guardian.

If each parent names a different guardian, whose choice will the court follow? The answer depends upon which parent dies first. The will of the first parent to die usually does not control the appointment of a guardian for minor children. In most circumstances, the court does not appoint a general guardian or a guardian of the person for a child if the child has a natural guardian (a parent).

These problems become particularly important for divorced parents or parents who were never married. Frequently, divorced or never married parents disagree about who should be appointed guardian for their children if both of them die before the children are adults. Sometimes the parent with custody assumes that he or she has the exclusive right to name a guardian for the children. If the parent with custody dies first, however, the parent without custody remains the natural guardian of the child or children and the clerk will not appoint a different guardian. A parent cannot cut off the parental rights of an ex-spouse by simply

naming someone else in a will as guardian. There are, however, other court procedures available to terminate parental rights when a parent has acted inconsistently with his or her parental obligations. Likewise, when a parent has acted inconsistently with his or her parental obligation, a third party, such as a grandparent, can petition the court for custody. Also, it is possible for someone who is not a parent, such as a grandparent, to ask the court for custody of the children even though one or both parents are still living. This is a heavy lift, as the non-parent would need to show the parent to be unfit.

A parent with a serious chronic or terminal illness may ask the Clerk of Superior Court to appoint a standby guardian, pursuant to N.C.G.S. 35A-1370. This guardian may be in place during the lifetime of both parents and the guardianship survives the death of the parent who petitioned for appointment. Presumably, no additional guardian would be appointed after the death of the last parent despite a recommendation in that parent's last will (although neither the statute nor any case law addresses this issue).

iii. Ability to Have Assets Managed Until Children or Other Beneficiaries Reach a Responsible Age. Generally, minor children cannot take outright ownership of assets left to them by will. If no provisions are made in the will for the management of gifts to minors, the following rules apply:

(1) Tangible personal property valued at $1,500 or less may be delivered to the parent or guardian of a minor, if the minor is living in the same household as the parent or guardian appointed prior to the testators's death and if the Clerk of Superior Court approves such a distribution; the parent or guardian is required to use the property solely for the education, maintenance and support of the child, but need not make further accounting to the Clerk. See N.C.G.S. 28A-22-7.

(2) Tangible personal property valued at $1,500 or more can be transferred to a guardian who is appointed by the Clerk of Court to manage the assets of a minor; the guardian must be bonded and provide an accounting to the Clerk.

(3) When the minor's inheritance includes intangible personal property or real estate, or if it includes tangible personal property worth more than $1,500 and no guardian of the estate of the minor has been appointed, then the Clerk of the Court will hold and manage the property and deliver it to the minor when the minor reaches 18 years of age.

To avoid the application of the above rules, a will can specify a method by which the minor's assets may be held. If the estate will pass only tangible personal property, the will can authorize the distribution of such property, regardless of value, to a minor child's parent, guardian or custodian and specify that no accounting need be made to the Clerk. Language can read as follows: *My executor may distribute tangible personal property passing to a minor, regardless of its value, to the minor's parent, legal guardian or another adult who has custody of the minor, and that person's receipt shall be a sufficient acquittance in the account of my executor.*

Trust for Minors: Generally, if the testator is passing property other than personal items to a minor, a simple trust should be established in the will. A responsible relative or friend can be named as the trustee, and the bond and accounting requirements waived. The testator can specify how the property is to be used; usually, the trustee is given wide discretion to use the property any way that he or she deems necessary for the general support of the minor child. The trust should specify when the property should be transferred to the beneficiary or otherwise how the trust ends.

Uniform Transfers to Minors Act – Custodianship: In the absence of a trust, property can also be passed to a minor pursuant to the North Carolina Uniform Transfers to Minors Act, N.C.G.S. 33A-1 through 33A-24. This statute allows gifts to be made to custodians for minors (under the age of 21), and regulates such custodianships. Custodians receiving property under this act are required to take control of the custodial property and hold, manage and invest the property for the benefit of the minor. The custodianship ends when the minor turns age 21, although the testator may authorize termination at age 18, 19 or 20. The custodian must keep the property separate from his or her own, and must keep records regarding the custodial property, but is not required to make accountings to the Clerk of Court. A single custodian must be appointed for a single child. A person may be appointed as custodian for several children, but there is a separate custodianship for each child; the assets of the several children may not be comingled.

A custodianship under the Uniform Transfers to Minors Act may be the simplest mechanism for distributing funds from an IRA or other retirement account to a minor, as long as the client is willing for the minor to receive the funds no later than at age 21.

Our will forms include language stating that any property that is to be

distributed to an individual under age 21 may be distributed to an adult who is named as custodian by the Trustee or Executor. Property that is directed to the trust would not be included in this directive. However if there is property owing to a minor that is not left to the trust, the Executor can name an adult to serve as custodian for the minor child's property and distribute the funds to the custodian.

iv. Personal Representative's Bond.

(1) Intestacy. If a decedent dies intestate, the personal representative is required to post a bond for the faithful performance of his duties in an amount equal to 125 % of the value of the personal property administered. The only exceptions to the bond requirement for an individual personal representative are when the personal representative is to receive all of the decedent's property or all of the intestate heirs are over 18 years of age and file a written waiver of the bond with the probate court. See N.C.G.S. Sec. 28A-8-1(b)(6)(7). The bond premium is paid from the estate.

(2) Testacy. Where the decedent's estate is administered under the terms of a will, the Executor is not ordinarily required to post a bond unless required under the express terms of the will. See N.C.G.S. Sec. 28A-8-1(b)(1)-(4). In addition, if the estate is administered by a national bank having its principal place of business in North Carolina or by a state bank, no bond is required. N. C. G. S. Sec. 28A-8-1 (b)(5). It is advisable for the testator to explicitly waive the bond requirement on the executor. (The forms used in the Duke Health Justice Clinic include specific waiver language.)

2. **Capacity to Make a Will.** Any person of sound mind, 18 years of age or over, may make a will. See N.C.G.S. Sec. 31-1. The mental capacity ("sound mind") required to make a valid will is satisfied if:

a. The testator knows the natural objects of his bounty (generally, his near kin);

b. Understands the nature and extent of his property;

c. Knows the manner in which he or she desires to dispose of his or her estate and realizes the effect that his or her manner of disposition will have upon the estate. See In Re Will of Womack, 53 N.C. App. 221, 280 S.E.2d 494 (1981).

3. **Types of Wills.** Several types of wills are recognized in North Carolina.

a. Nuncupative Will. A nuncupative will is one made orally by a person who is either terminally ill ("last sickness") or in imminent peril of death and who does not survive such sickness or imminent peril. The will must be declared orally by such person before two competent witnesses simultaneously present and specifically requested by him or her to bear witness thereto. See N.C.G.S. Sec. 31-3.5. Only personal property may be disposed of by a nuncupative will. See N.C.G.S. Sec. 31-3.2(b).

b. Holographic Will. A holographic will is one written entirely in the testator's handwriting (the fact that other words or printed matter appear on the paper, not in the testator's handwriting, which do not affect the meaning of the testator's handwritten words does not affect the validity of the will). It contains the testator's handwritten signature and it is found after the testator's death among his or her valuable papers, in a safe-deposit box or other safe place where it was either deposited by him or her or under his or her authority or in the possession of some person, firm or corporation. No attesting witnesses are required. Although not required by statute, it is desirable that the holographic will be dated.

The unfortunate thing about holographic wills is that the testator often does not fully understand the requirements for effecting a logical and total disposition of assets. For example, holographic wills frequently fail to name an executor, fail to give the executor specific powers, fail to dispose of the entire interest in property, etc.

Holographic wills can, to a limited extent, be a helpful adjunct to a typewritten attested will as a means of disposing of certain items of tangible personal property without the necessity of requiring a formal codicil to an existing will. Probate of a holographic will requires two witnesses to the testator's handwriting and a witness to the place where the will was found. See N.C.G.S. Sec. 31-18.2.

c. Attested Written Will. An attested written will is a will signed by the testator and attested by at least two competent witnesses. In order to be valid:

i. The testator must, with the intent to sign the will, either do so personally or by having someone else in his or her presence and at his or her direction sign his or her name thereon.

ii. The testator must signify to the attesting witnesses that the will is his or her will by either signing it in their presence or by acknowledging to them

his or her signature previously affixed thereto, either of which may be done before each attesting witness separately.

iii. The attesting witnesses, who must be at least 18 years of age and mentally competent, must sign the will in the testator's presence but need not sign in the presence of each other. See N.C.G.S. Sec. 31-3.3. Note that in some states the witnesses need to sign in each other's presence and, when possible, the will should be executed in that manner so that it may be probated in one of those states if necessary.

As a means of unequivocally establishing the appropriate execution of the will, it is desirable for the will to contain recitals to the effect that the testator signed the will in the presence of the witnesses and that they each sign in the testator's presence and in the presence of each other.

Many practitioners use three rather than two witnesses in order to satisfy the requirements of other states relating to the number of required witnesses, as some states require three rather than two witnesses. The forms we use in the Duke Health Justice Clinic have spaces for only two witnesses, due to the inconvenience of having three witnesses.

d. Joint Wills. Couples will frequently ask the attorney to prepare a "joint will" for them. A joint will is a will signed by two or more persons as their separate wills, and it is probated after the death of each testator. Joint wills are not favored by the law, and they frequently result in litigation for breach of contract when the survivor executes a new will following the first party's death. Attorneys should discourage their clients from executing joint wills and advise them that the attorney will prepare mutual wills with similar or reciprocal provisions in them.

e. Witnesses. Except in the case of a holographic will, witnesses to the will cannot take anything pursuant to the will. See N.C.G.S. Sec. 31-10(a). Therefore, all witnesses should be totally disinterested parties. Unless the will is a self-proving will, described below, the witnesses will need to appear before the Clerk of the Court at the time of probate to "prove" the validity of the will.

f. Self-Proving Will. By statute, North Carolina provides a procedure whereby the signatures of both the testator and the attesting witnesses may be notarized at the time of executing and witnessing the will. This procedure, if followed, allows the will to be admitted to probate without the usual necessity of having the witnesses examined either by the probate court or otherwise at the time of death. In addition, it eliminates the necessity of locating missing witnesses who may have long since moved away from the area in which the will is being offered

for probate. This "self-proving" of attested wills is recommended for use in all circumstances. See N.C.G.S. Sec. 31-11.6, which contains recommended language for inclusion in the will and attestation clauses. This procedure may also be used in connection with wills already executed.

The wills used by the Duke Health Justice Clinic all include the language that makes the will self-proving.

g. Wills Made in Another State. Generally, a will which disposes of real property located in North Carolina must be executed (signed and witnessed) in accordance with North Carolina law in order to be valid. In contrast, the validity of a will disposing of personal property is determined by the laws of the state in which the decedent was domiciled (living) at the time of death even though the personal property is located in North Carolina.

h. Property That Cannot Be Disposed of by Will. Property owned by husband and wife in "tenancy by entirety" is owned, after the death of one, solely by the survivor. If property is owned by two or more persons in "joint tenancy with right of survivorship," the survivor takes all. Proceeds of insurance policies, pension and other retirement funds, United States savings bonds, P.O.D. (payable on death) deposits or other assets in which a beneficiary is named cannot be disposed of by a will unless the estate is named as beneficiary. These items are known as "non-probate assets."

i. Wills to Disinherit Specific Persons. Generally, the maker of a will has the right to disinherit persons, including children, who would otherwise inherit property had the person died intestate. Children have no vested right in their parent's property. However, in North Carolina, a spouse cannot be disinherited under a will; the spouse is always entitled to dissent from a will that does not give him or her at least a specified minimum share. See N.C.G.S. 30-1. A divorce after a will has been written does not revoke such will. The divorce does, however, revoke all provisions in the will in favor of the divorced spouse.

4. **Alternatives to Wills.** There are numerous ways interests in assets can be transferred at death without the use of wills. It is important for an attorney to know what use of these "will alternatives" has been made by the client in order for the attorney to be able to advise the client about the availability of these methods.

a. Probate vs. Non-Probate. Many clients are concerned with what they believe to be the high cost of probating the last will and testament. There are in fact a number of states in which it is expensive to go through the probate process. The fees in North Carolina are generally not prohibitive. No estate is charged more than $6,000 in probate fees. See N.C.G.S. 7A-307. There is no probate fee in

North Carolina on certain assets such as real estate (unless the estate must sell the real estate to pay debts and taxes), life insurance, retirement plans and annuities payable to a named beneficiary (unless the estate or the executor of the estate is the named beneficiary) and assets owned jointly with right of survivorship that pass to the co-tenant by operation of law. Thus, many clients have little or no assets that actually pass through the probate process.

Some clients confuse the cost of the probate process with the tax cost of transferring assets to beneficiaries. The probate fees paid to the Clerk of Superior Court are in addition to any taxes owed to the Internal Revenue Service or the North Carolina Department of Revenue. Generally, avoiding the probate process does not increase or decrease any estate or inheritance taxes due.

Nevertheless, there may be other reasons to avoid the probate process. In actuality, avoiding the probate process may save attorney's fees that might be involved with the transfer of assets through the probate process. Furthermore, avoiding the probate process may be important for family privacy reasons. All assets that go through the probate process are listed in the office of the Clerk of Superior Court of the county in which the decedent died and are therefore public information. Assets that do not go through the probate process are not necessarily listed in the office of the Clerk of Superior Court and may be kept private. Often, there are reasons that an individual does not wish the disposition scheme of his or her estate to become public knowledge because he or she may be treating different heirs differently.

b. Joint Ownership. Assets can be jointly owned as tenants in common or joint tenants with rights of survivorship. Under North Carolina law, real property owned jointly with a spouse is owned as tenants by entireties (i.e., with rights of survivorship) unless the deed specifies that the ownership is a tenancy in common. Unmarried couples may also own real estate as joint tenants with right of survivorship whereby the survivor inherits the interest of the deceased partner outside the probate process.

Personal property can be owned with survivorship rights in North Carolina only by an express contract. It is necessary to examine the signature cards of deposit accounts, stock certificates and other evidences of title to determine whether there are survivorship rights. Also note that under N.C.G.S. Sec. 41-2. 1, a portion of some deposit accounts may become probate assets even though there are survivorship rights. Since implementation of a law effective July 1, 1989, most financial institutions can now offer survivorship accounts which avoid probate, but if your client executed a signature card for a joint account at a bank (as opposed to a savings and loan) prior to July 1, 1989, it is likely that the account is subject to N C.G.S. Sec. 41-2.1 (see if the signature card refers to that statute). If

one of the purposes of the joint account was to avoid probate, the joint tenants should execute a new signature card which does not refer to N.C.G.S. Sec. 41-2.1. Then, the account would be governed by N.C.G.S. Sec. 53-146-1 which provides that all of the funds in such account would be owned by the survivor after the death of a co-owner (subject to the right of the personal representative of the deceased co-owner to seek a return of sufficient funds from the surviving co-owner to pay funeral expenses, debts or other allowable expenses of the estate of the deceased co-owner). Unmarried couples may take advantage of N.C.G.S. Sec. 53-146.1 to provide for survivorship just like married couples.

While joint ownership with survivorship rights can provide a simple, inexpensive method of transferring title at death, it can also defeat the estate plan created under the will if the draftsman was not aware of the survivorship interest. Be aware that the survivorship provisions of the deed or signature card override the will's purported disposition of the asset (except in the unusual situation of the surviving tenant clearly being given an equitable election to take under the will as opposed to receiving his survivorship interest).

c. Beneficiary Designations. Life insurance policies, retirement plans, Individual Retirement Accounts and some types of annuity contracts permit the owner to designate who receives death benefits payable under the policy, plan or contract. Unless the decedent's estate is the beneficiary, the death benefits will be paid directly to the person(s) designated and will not be controlled by the Will.

i. Reasons not to name estate as beneficiary. There is a tendency of some clients to name their estate or the executor of their estate as beneficiary of their life insurance policies, retirement plans, individual retirement accounts and annuities both for the sake of simplicity and for the sake of privacy. There are, however, important reasons not to name the estate or executor of the estate as such a beneficiary. First, naming the estate or executor of the estate as beneficiary of such assets makes those assets subject to probate when they would not otherwise be subject to probate if a specific beneficiary other than the estate were named. Making these assets subject to probate subjects them to the probate fees. More importantly, however, naming the estate or the executor of the estate as such a beneficiary subjects those assets to claims of creditors of the estate. If an individual or trust for an individual is named as the beneficiary of insurance, retirement plans, individual retirement accounts or annuities, then those assets pass to the named beneficiary exempt from claims of creditors of the estate, including claims of the Internal Revenue Service for income taxes owed by the decedent at the time of his death. See North Carolina Constitution, Article X, Sec. 5 and N.C.G.S.

Sec. 58-58-95. Therefore, the estate or the executor of the estate is not an acceptable beneficiary for any of such assets.

For retirement accounts such as an IRA, 401K, or other tax deferred retirement account, there are additional considerations about beneficiaries that impact the taxation of distributions from those types of accounts. These are very complex rules that may require referral us to refer the client to an outside expert if the client wishes to leave such accounts to a minor or a trust.

ii. Secondary beneficiary. It is extremely important that a client name both a primary and secondary beneficiary of all insurance, retirement plans, Individual Retirement Accounts and annuity contracts. Many people name a primary beneficiary but not a secondary beneficiary. The lack of a secondary beneficiary means that the estate of the individual is the secondary beneficiary, resulting in the disadvantages mentioned above with such assets being subject to probate and subject to claims of creditors.

In a situation in which a client wishes minor or young children to be the either the primary or the secondary beneficiary of life insurance, it is extremely important to have a trust named as the beneficiary of those items. The trust is created in the will, then the beneficiary designation in the policy or plan names "Jane Doe as Trustee for Joe and Susie Smith under the Last Will and Testament of Sally Smith." If the client wishes to name a minor or a trust as a retirement account beneficiary, please consult with your supervising attorney, as we may need to refer this client out.

iii. Insurance taxability. Insurance agents frequently describe life insurance as "free," referring to the fact that the proceeds are usually not subject to taxes. Be aware that many clients mistakenly believe that the proceeds are free from estate taxation if paid directly to a beneficiary rather than to an estate. If the decedent had any incident of ownership in the policy (i.e., could change the beneficiary) or transferred an incident of ownership within 3 years of his death, the policy is includable in the gross estate for estate tax purposes.

d. Inter Vivos Trusts. Some people create trusts during their lifetime and transfer assets to them as a way to avoid probate. This mechanism is generally used by persons significant assets, unlike most clients of the Health Justice Clinic. The Health Justice Clinic does not generally create inter vivos trusts.

e. Custodianships under the Uniform Transfers to Minors Act. A simple, inexpensive method of transferring assets to a minor without the use of a trust or a will is by establishment of a custodial account for the minor under the North Carolina Uniform Transfers to Minors Act, N.C.G.S. Secs. 33A-1 et seq. The custodian invests the assets and can use them only for the benefit of the minor. At age 21, the assets must be distributed to the beneficiary. To ensure that the assets transferred to the custodianship are not included in the custodian's gross estate, the donor should name someone other than himself as custodian. Custodianships under the UTMA can be useful when dealing with small retirement accounts where the child is the primary or secondary beneficiary.