

Intestacy: Consequences and Alternatives

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ISSUE: A husband with a multi-million dollar net worth died in his 60's without a will, a situation known in legal circles as dying intestate. His failure to plan ahead for the unexpected resulted in all of his assets passing to his heirs through probate and split according to his state's intestacy laws rather than his wishes. What might he have done differently had he created a plan? What do his widow and children do now?

Alternatives to intestacy:

- Create a will, right now! In the above case, a will would have at least made his intentions known although it would not have allowed his widow and heirs to avoid probate.
- Own assets jointly, or hold them in an IRA, both of which would bypass probate.
- Create a trust to hold assets and avoid probate.

What happens to his assets now that he died intestate?

Probate will take place and assets are divided among his wife and three children according to the laws of intestacy for their resident state. In this case, each heir received an equal share, so the widow gets 25%, the same amount as each of her children. His wife did not get it all! With a life expectancy of over 20 years and the widow's plans to not work during that time, this amount may not be enough. And his children may not be responsible enough to handle their portions.

One way to provide the widow with more assets is for the children to "disclaim" their portion and let their mother have inherit a larger portion. The family should take into account the financial implications of this decision beyond the obvious inheritances in each heir's pockets. Disclaiming assets has its advantages and disadvantages:

- Advantage - The widow has more money to live on until she passes when her children get the inheritance they had originally disclaimed.
- Advantage - There is no estate tax due on any asset that goes to the wife due to the marital exemption. If all the children inherit a combined total of more than \$1.5 million in 2005, the estate will pay federal estate tax (the top tax rate is 47%) on the overage.
- Disadvantage - Adult children may not like disclaiming assets simply because they inherit less now.

- Disadvantage - The amount disclaimed may constitute a waste of their father's lifetime estate tax exemption unless the disclaimed assets go into a credit shelter trust. In 2005, this would be of concern if the parents have an estate greater than \$1.5 million.

What is the value of his estate exemption?

The value of the husband's estate exemption is the marginal estate tax rate multiplied by the amount going to the children. For example, if the above husband has a gross estate of of \$3 million (generally speaking, the gross estate includes all assets held solely in his name plus any death benefits paid out by his life insurance policy), each child would receive 25%, or \$750,000. The total going to his children would be \$2,250,000, and the husband's estate tax exemption would cover \$1,500,000. Therefore, \$750,000 would be subject to federal estate tax, yielding a tax bill of roughly \$350,000.

Conclusion: Can the widow's finances be structured in a way that protects her from running out of money before she dies while at the same time minimizing income and estate taxes? The answer is yes, but it will require a sophisticated financial blueprint to design the appropriate structure. The Monitor Group can perform a stochastic modeling analysis to provide the widow with probable financial implications of her decisions during this difficult time.

Cal Brown is Vice-President of The Monitor Group, Inc., a fee-only financial planning firm located in the Tyson's Corner area of McLean, Virginia. As a nationally recognized wealth management firm, The Monitor Group provides investment and financial planning services to more than 190 high net worth client families in Northern Virginia, Maryland, Washington, DC and across the country.