

Business & Law Newsletter

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COMMONLY OVERLOOKED ASPECTS OF AN ESTATE PLAN

When asked whether our estate plan is up to date, most of us consider only whether we have wills and, if applicable, trusts in place. There are, however, other important aspects of an estate plan that should not be overlooked.

Without proper business planning, the death, retirement, disability, or divorce of a key owner can cause a multitude of problems for the family of such key owner, for other owners, and for the business itself.

TITLE AND BENEFICIARY DESIGNATIONS

An important step in estate planning is to determine how each asset will pass upon death. It is necessary to review existing beneficiary designations for insurance policies, annuities, employee benefit plans and certain bank accounts and to review how assets are titled. The designation of a beneficiary is a contractual agreement which is controlling regardless of the terms of a Will. Furthermore, the way an asset is titled can control how it passes upon death. For example, accounts owned as joint tenants with rights of survivorship or as community property with rights of survivorship will pass automatically to the surviving owner in the event of a death.

An asset that has a designated beneficiary or is titled to give surviving tenants full ownership is deemed to “pass outside the will.” If a Will contains one or more specific bequests or tax planning that is dependent upon the proceeds from such asset, such bequests or planning may ultimately fail.

Assume, for example, that Jack and Jill are a married couple who own assets valued at \$1 million. They also have a \$2 million life insurance policy on Jack’s life. They have executed Wills which contain “bypass” or “credit shelter” trusts designed to maximize the use of the available estate tax exemption for the estate of the first spouse to die. Jack has named Jill as the beneficiary of the life insurance policy. In 2005, Jack dies first. His estate is valued at \$1.5 million (his community one-half (1/2) of all assets). \$500,000 of Jack’s estate will flow into the bypass trust (no estate tax because it is under the \$1.5 million exemption amount) and \$1 million of Jack’s estate passes outright to Jill because of the insurance beneficiary designation (no estate tax because of the marital deduction). Later in 2005, Jill also dies. Jill’s estate consists of \$2.5 million (her community one-half (1/2) of their assets plus what she received upon Jack’s death). An estate tax is levied on \$1 million dollars (the amount over the \$1.5 million exemption amount). Had the bypass trust been designated as the beneficiary of Jack’s community one-half of the insurance proceeds, there would have been no estate tax due upon Jill’s later death.

DISABILITY PLANNING

In addition to planning for the disposition of assets upon death, it is also important to insure that proper documents are in place to protect you and

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your family in the event of your disability or incapacity. These may include powers of attorney for property management and for medical decision-making authority and living wills. Without the proper documentation, it may be necessary for your family to seek a court-supervised guardianship to care for your person and estate. Because of the continuing court supervision, guardianships can be very expensive, burdensome and restrictive.

BUSINESS PLANNING

Owners of closely-held business interests should take additional steps to protect their interests upon the happening of certain key events. Without proper planning, the death, retirement, disability, or divorce of a key owner can cause a multitude of problems for the family of such key owner, for other owners, and for the business itself. Consider some of the following questions to determine if planning should be undertaken:

- What will happen to my business interest upon my death?
- What is the value of my business interest for estate tax purposes?
- Will my family continue to receive adequate support from the business?
- Will my family be able to sell the business interest if necessary?
- Who will I be in business with if my partner dies, becomes disabled, retires, divorces or simply decides to sell his or her interest?
- What funds are available for the purchase of a key business owner's interest?

If the answers to the above are uncertain or undesirable, you and your business partners may want to consider entering into an agreement containing buy-sell provisions that are triggered upon the occurrence of certain events. Such an agreement can, among other things, (i) provide a procedure for the liquidation of an owner's interest in the event of forced or voluntary withdrawal; (ii) prevent outsiders from obtaining an ownership interest; (iii) ensure the continued legal existence of an entity; (iv) ensure continuity of management; (v) create a market for the shares of a deceased, retiring or withdrawing partner; (vi) provide cash to pay estate settlement costs and taxes; and (vii) fix the value of the interest for estate and gift tax purposes. As a part of such planning, the partners will also want to insure that the agreement is properly funded such that there are sufficient assets available to fund a buy-out of a key owner's interest.

If an agreement is currently in place, it is imperative that the owners review it regularly to check that the terms continue to be fair and reasonable and to check that the agreement continues to be properly funded. ■

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