Estate Planning

Understanding the probate process.

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Many people will experience the probate process in order to administer the estates of loved ones who have passed away.

This article is provided to help demystify that process and explain the procedural steps that normally occur during probate; and perhaps also to inspire those who may have developed a greater respect for the fragility of human life as a result of the pandemic to undertake the estate planning process in earnest—clarify your wishes and ease the legal obligations your death will impose on your loved ones.

PROBATE. The probate process is an established set of state procedures to officially determine the successor ownership of property and rights held by a decedent.

According to the law, property always has a rightful owner; what remains to be determined is who that successor owner is after the death of the existing owner, and to have the successor officially declared for later transactions and third parties. If not identified by the decedent with a will, the heirs to the decedent must also be determined and officially established. During the pendency of the estate, or the period of time awaiting the settlement, the probate court will:

- Appoint a personal representative to marshal and protect the decedent's property;
- Provide an inventory;
- Notify creditors and beneficiaries; and
- Administer and distribute the estate to its rightful owners upon successful completion of all the tasks to be accomplished.

INTESTACY. A decedent may leave a last will and testament that specifies who the successor owners to the property shall be; however, some decedents fail to do so. When a person dies in intestacy — without a legal will — distributing their assets becomes the responsibility of a probate court. As a result, each state will apply a default set of statutes called intestacy statutes, which determine where property passes for those not leaving a will. These statutes vary in the percentages or priority in each state, but most leave the property to spouses, children, parents, and siblings.

In scenarios where a person's loved ones fall outside of these familial classifications, it is imperative to create a will prior to death or loved ones will receive none of the property which passes through the probate system.

Another alternative in these scenarios is to structure the property's title in a manner that it transfers directly to the intended beneficiary without using the probate process. These assets are referred to as non-probate property.

NON-PROBATE PROPERTY. Not all property passes through probate. Assets that pass or transfer under a contractual agreement, or property owned with title that passes as a matter of law upon the death of a titleholder, are referred to as non-probate assets. These assets generally do not require a will to direct their disposition, so they do not pass through probate. Assets such as right-of-survivorship property, retirement plans, pensions, annuities, life insurance policies, and pay-on-death accounts at financial institutions are typical non-probate assets.

However, non-probate does not mean that these assets never pass through probate. If the decedent's estate is specifically named as a beneficiary, or the original beneficiary designations or the successor titleholder fails due to death or the designation being voided by statute (such as former spouses in certain states), the non-probate assets can pass through the probate process.

When this occurs, the assets typically become subject to public disclosure and potential estate creditors. In the case of retirement plans or tax-deferred assets, detrimental income tax consequences may result. For estate tax purposes, the IRS includes the value of non-probate assets in the decedent's gross estate when assessing estate tax liability.

Considering the types of assets comprising an estate is an important component when planning for their disposition. Many beneficiaries have been surprised to learn that an estate divided equally among the decedent's loved ones expressly provided for in a will, is in fact, overly lopsided due to a substantial insurance policy or a pay-on-death account with a designated beneficiary.

TRUSTS. Assets owned by a trust also do not pass through probate at the death of the decedent, unless the trust language provides for such a transfer or disposition. A trust is the separation of legal and equitable or beneficial title. A trust is not an entity but rather a bifurcated ownership interest in property. Such a separation can create opportunities for asset protection and tax benefits in some cases; however, if the trust is improperly funded, the property will pass through probate, subjecting those assets to both disclosure and estate creditor claims.

A decedent does not outright own property properly transferred to a trust, so his or her death would not subject those assets to his or her probate estate. The decedent's death may serve as a trigger for a transfer or distribution from the trust, but only as the language of the trust directs.

THIRD PARTIES. When a person dies, active contracts for which the decedent was a party must be reconciled, transferred, or closed out. Also, the obligations and debts of the decedent must be addressed and settled. For example, a common third party in estates are secured lenders for vehicles and real estate. Probate provides the procedure and forum for this to occur.

If insufficient assets remain to pay all creditors, then a multi-tiered creditor classification system exists to prioritize the creditors' claims until the assets are exhausted. State governments have been increasingly looming large in decedent's estates with Medicaid recovery claims.

PROTECTED ASSETS. If creditor claims exceed the estate's assets, the estate is considered insolvent, and the decedent's beneficiaries would ordinarily receive nothing since the payment of creditor claims will exhaust all of the property. However, most states provide for family allowances and exemptions for certain assets passing to spouses or dependent children.

Allowances and exemptions are protected set-asides which help prevent leaving surviving spouses and dependent children destitute upon the death of their spouse or parent. These allowances and exemptions may not be automatically applied, depending upon the state, but if available should generally be requested.

Conclusion

Although much maligned, many states' probate processes provide effective and efficient administration at minimal costs, provided the decedent had a competently drafted and executed will.

Many states have streamlined the probate process and permit independent administrations to limit court appearances and keep legal costs down. Some states even permit abbreviated or minimal requirements for smaller estates where the typical administration expenses would consume the bulk of the modest estate.

When a loved one's death occurs, consultation with trusted advisors familiar with your state's probate and estate planning opportunities is a solid first step to avoid costly errors and chart an optimal course through the probate process.

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