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ESTATE PLANNING

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WHO GETS YOUR IRA? – SIX COMMON MISTAKES

by David M. Watts, Jr.

Do you want your heirs to have to chase after your 401K or IRA money? It is important to make sure you have an up-to-date beneficiary form. On January 26, 2009, the United States Supreme Court unanimously ruled in the case of *Kennedy vs. DuPont* that the plan administrator was not required to honor a divorce decree. William and Liz Kennedy were married in 1971 while William was an employee of DuPont and a participant in its Savings and Investment Plan. William designated Liz as the sole beneficiary of his plan benefits. When William and Liz divorced in 1994, the divorce decree terminated any of her rights to William's pension or retirement benefits. William never changed his beneficiary form. When William died in 2001, his estate demanded the plan funds based on the domestic relations order. The DuPont plan administrator refused and disbursed the funds to Liz, in reliance on William's beneficiary form. The ex-wife, who was still listed on the beneficiary form, gets the money, even though the divorce court ordered her rights terminated and she signed a waiver.

It is important to understand that your will does not control who gets your 401K or IRA. The beneficiary form trumps your will. Filling out the beneficiary form correctly is critical. The biggest mistakes:

Mistake #1

The beneficiary form cannot be found. While the Supreme Court made it clear that the beneficiary form rules, if there is no form filed with the plan administrator, you are stuck with the default provisions of the plan. Often it will go to your estate, but this is not always the case. Make sure you can find the most recently filed form. Do not assume that the plan administrator will be able to find it either. With companies merging, going out of business, getting sold, or moving, files get lost or misplaced. The solution? Get an acknowledged copy of your beneficiary form from the plan administrator. Make sure that you keep the forms in a place that you and family can easily find. All of your planning goes out the window if the form cannot be found.

Mistake #2

The form is out of date. Have there been any changes in your life, such as marriage, birth of a child or grandchild, divorce, job change, retirement, a death? Remember that your will cannot change the beneficiary of your plan! It is imperative that you review the beneficiary form regularly. Another problem we see is accidental disinheritance of a child's family. You name your three children as beneficiaries, intending each child to receive 1/3rd. Your oldest child predeceases you. At the time of your death your two surviving children receive 50% each instead of the 1/3rd you intended. Your oldest child's family gets nothing. The solution? Review the form annually. Tax time is an ideal time since you are reviewing all of your financial records anyway.

Mistake #3

You have not named a backup beneficiary. If you do not name a back up beneficiary then any number of people could get the plan assets, or your estate. Each plan administrator has its own rules for this kind of situation. Example: you name your spouse as the only beneficiary. If your spouse dies before you, there is no beneficiary so your 401K or IRA may be liquidated, taxed and what is left will be distributed to your estate. It is a good idea to name someone, say your children, or a trust for your children, as the contingent beneficiaries. A single person may name his or her parents first and then a favorite charity as the backup beneficiary. Naming a charity as the primary or contingent beneficiary of your 401K or IRA is a great planning technique because the charity will pay no income tax upon receipt of the IRA funds.

Mistake #4

Naming a minor as a beneficiary. A minor cannot control funds, and a court appointed guardian will be in control. When the child turns 21 (18 in some states), the child will have unfettered access to the funds. The solution? Set up a trust so the funds are managed under your instructions, and by people of your choice.

Mistake #5

Missing out on the stretch IRA opportunity. The stretch IRA is set up through your beneficiary form. Stretching the IRA payments over the lifetime of the beneficiary allows the IRA to grow tax deferred while making relatively modest annual distributions. But, IRS statistics show that 90% of IRAs are cashed out within 6 months of death. The solution? Again, a trust can be put in place to make sure that the funds will be used over a lifetime instead of immediately withdrawn.

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ESTATE PLANNING FOR DIGITAL ASSETS *by Andrew S. Rusniak*

It is often said that the law lags behind technology. One area where this sentiment is particularly applicable is estate planning for digital assets. In a world where our lives are becoming ever more digital, many estate planning practitioners unfortunately attempt to rely on traditional planning principals for the disposition of digital assets, avoid the issue altogether because of a lack of understanding, or simply fail to consider digital assets in the estate planning process. However, the cost of ignoring or improperly planning for a client's digital assets can be significant, and a complete estate plan should address the disposition and administration of digital assets.

The task of an executor has always been to identify the decedent's assets, pay the decedent's liabilities and debts, and distribute the decedent's assets pursuant to the terms of the Last Will and Testament. Traditionally, this process generally involved a search of the decedent's records, and accounts and bills were identified through stored records or subsequently received mail. However, as our lives become ever more digital, this paper trail may no longer exist. For example, service providers continue to promote "paperless billing" through the use of promotions and discounts. Receipts are e-mailed rather than printed. Where an individual has failed to properly plan for the disposition of digital assets, bills may go unpaid, assets may be forgotten or forever lost, and the estate administration process may generally be unnecessarily delayed. With technology so intertwined into our daily lives, it is important that the estate planning process account for a client's digital assets.

An important first step in the process of estate planning for digital assets is to understand the definition and scope of digital assets. Although there is no uniformly accepted definition, digital assets generally include digitally stored content, online accounts and files stored on digital devices, such as computers and smartphones. In addition, accounts managed and maintained on the internet, such as e-mail, social networking sites, eBay, PayPal, Amazon.com, and YouTube; online storage accounts, such as Apple's iCloud, Google Drive, and Dropbox; and music accounts, such as iTunes and Pandora, all constitute "digital assets."

One of the most important tasks of an estate planning attorney is to fully comprehend the nature and extent of a client's assets to properly provide for the appropriate disposition of each asset. For this reason, one of the first steps of many estate planners when beginning the process of estate planning for a new client is to ask the client to prepare either a personal financial statement or an inventory of assets. It is important that a client be advised to include a comprehensive inventory of digital assets in addition to the assets that are otherwise traditionally accounted for, such as bank accounts, real estate, vehicles, and brokerage accounts. Digital assets can be difficult, if not impossible, to identify if not properly catalogued, and many digital assets may prove to have considerable financial or sentimental value. For example, if a decedent sold a vehicle shortly before death and accepted payment by way of a PayPal transfer, a significant sum of money could be sitting in the PayPal account. Because PayPal generally communicates with its users by way of e-mail, an improper inventory that does not include the decedent's PayPal account information could result in a failure to locate this asset. Similarly, the process of scrap booking and photo collecting has undeniably gone digital. While unlikely to have a significant financial value, irreplaceable photos of family and friends stored in online accounts can be lost forever if account information is not properly recorded for use by an individual's fiduciaries. As a result, a complete inventory of digital assets should include the user names and passwords for all digital assets.

In addition to compiling an inventory of digital assets, an estate plan should also authorize a client's fiduciaries to access, maintain, distribute and dispose of digital assets. In general, every estate plan includes a Durable General Power of Attorney and a Last Will and Testament. Most Power of Attorney documents authorize an agent to pay bills, engage in banking and real estate transactions, pursue tax matters, and generally access and maintain all other property of a principal. However, with the pervasiveness of digital assets, a Power of Attorney should also specifically authorize an agent to access, use, control, modify, delete, and transfer a principal's digital assets. In addition, a Last Will and Testament should specifically authorize an executor to access, handle, distribute, and dispose of all digital assets. It may also be advisable to reference an external inventory of digital assets, which should contain the relevant user names and passwords, in order to inform the executor of the existence of a decedent's digital assets.

It is important to note that despite the best planning, certain statutes have been enacted that will have a significant impact on the planning for and administration of digital assets. At the federal level, the Computer Fraud and Abuse Act and the Stored Communications Act are designed to prevent unauthorized access of electronically stored information and also to prevent service providers from knowingly disclosing the contents of electronically stored communications. At the state level, the Pennsylvania House of Representatives recently proposed House Bill No. 2580 to amend the Pennsylvania Probate, Estates and Fiduciaries Code to permit a personal representative to "take control of, conduct, continue or terminate an account of the decedent with a social networking website, microblogging or short message service website or e-mail service website." However, as of the date of this writing, the House has not voted on H.B. 2580. To complicate things even further, almost every type of digital asset will be subject to a unique Service Provider Agreement ("SPA"), which, despite any state law to the contrary, could limit a fiduciary's access to and control of a digital asset.

A complete estate plan should address the disposition and administration of digital assets. Additionally, fiduciaries administering and managing an individual's estate should be mindful of potentially valuable or emotionally significant digital assets and should be cognizant of laws and SPAs that may have an impact on the disposition or administration of such assets. As a result, clients whose estate plans may not have been recently updated to address digital assets are encouraged to review their estate plans with counsel, and fiduciaries are encouraged to seek advice regarding compliance with federal and state laws and SPAs when administering digital assets. ■

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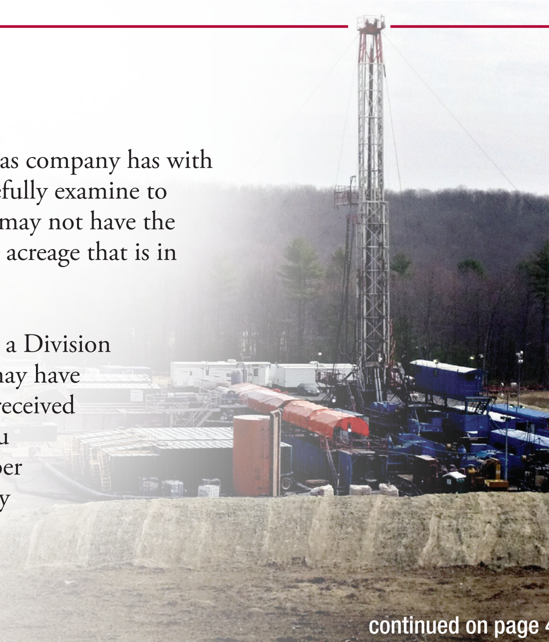
POST-PRODUCTION ISSUES AND OIL & GAS LEASES *by J. Corey Reeder*

So your oil and gas lease has now converted from the primary term to the secondary term – now what? There are several issues that a landowner or mineral interest owner should be aware of at this stage of the lease. Specifically, you should analyze the Declaration of Pooling Units (DPUs), Division Orders and Royalty Statements.

In the current resource plays like the Marcellus and Utica Shale, horizontal wells are standard and almost all wells are unitized among various surface/mineral owners. At some point after the Lease converts to the secondary term, you should have received a DPU. Although a DPU is not required under Pennsylvania Law, unless the Lease specifically provides for it, most gas companies will provide one to the owner and record the same in the Recorder of Deeds for the county in which the unit is located. A DPU is a document that identifies the size of a production unit for gas development and the corresponding parcels of real property that comprise the production unit. The first step you should take upon receipt of a DPU is to confirm that all the information related to the parcel is accurate. Specifically, you will want to confirm that title to the property is in your correct name, the total acreage size of your property is correct, the amount of your acreage that is in the production unit is correct, and consequently the percentage of your land in the unit is accurate and that the map that is attached to the DPU is correct. Further, if you have a Pugh clause in the Lease related to either horizontal or vertical portions of the total leased premises that would be released if not placed into a unit, then you should carefully review the DPU to determine whether or not the primary term of the original Lease has expired and if so, that the vertical depths and/or surface acreage that is not part of the DPU have been released. If a Pugh clause does exist and acreage should be released, you will need to review the Lease to determine what requirements the gas company has with respect to recording any such releases. With respect to the map contained in the DPU, carefully examine to confirm that the parcel is correct from a metes and bounds standpoint as the gas company may not have the correct survey information. This is important because it would impact the amount of your acreage that is in the unit and ultimately the percentage of the royalties that you would get from the unit.

In addition to the DPU, once the secondary term commences you should expect to receive a Division Order from the Lessee or by the Lessee and any other gas companies to whom the Lessee may have assigned a working interest. The first thing an owner should do when a Division Order is received is review the Division Order to make sure that the information is accurate. Specifically, you should review the title to the property, the tax parcel ID number to the property, the number of acres of the property, the number of acres of the property in the unit, and also the royalty percentage that you are entitled to. In addition, you need to make sure that the Division Order does not contain any language that would change the terms of the Lease. If you receive multiple Division Orders from various gas companies, you will want to review



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Mistake #6

Not providing creditor protection for the beneficiary. Would you like to protect your child's inheritance from divorce, lawsuits, creditors, business failure, or even bankruptcy? Some children suffer from poor money management skills and others have special needs. Assets retained in IRAs are much safer for these purposes than assets held outright. A trust can be used to restrict assets held in a stretch IRA.

The bottom line: Done correctly your 401K or IRA can preserve some significant funds for future generations to enjoy. The rules surrounding retirement plans and IRAs are complicated enough, but don't compound the difficulty by not paying attention to your beneficiary forms. When a good portion of your assets consist of a retirement plan you need expert help. ■

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your Lease to determine whether or not the Lease had any language related to the assignment of the Lease. A well drafted Oil & Gas Lease should provide that the Lessee is permitted to assign a working interest in the Lease to one or multiple entities, however, notice of the assignment would have to be provided to the owner/lessor as well as contact information related to the assignee. If you have such language in your Lease, you will want to obtain copies of all the assignments from the original Lessee gas company and make sure they have complied with the terms of the assignment provision. If you do not have such language, then you should try and request this information from the gas company. Once these items have been confirmed, you need to confirm that the decimal interest that you will be receiving from the unit is accurate. The decimal interest is calculated by dividing the amount of acreage that you have in the unit by the total acreage in the unit and then multiplying that number by the royalty interest that you are to receive. This calculation will give you a decimal interest number which will tell you what fraction of the total royalties out of that unit you should expect to receive. For example if you have 100 acres in a 600 acre unit and the royalties under the lease are 16%, the decimal would be calculated as follows:

$$(100/600) \text{ X } 16\%=0.0266667$$

Once you have determined that the Division Order is accurate and have signed and returned it to the gas company, you should expect, in the near future, to receive your first Royalty Statement.

Royalty Statements can be confusing documents to review as there is no statutory standard for the format and each gas company uses different forms. That being said, all Royalty Statements should contain similar information. The key items that you should be concerned with are: (i) confirm that the decimal interest that was calculated in the Division Order is the same listed on the Royalty Statement; (ii) determine whether or not the royalty check received is made payable to the right person or entity; and (iii) review post production deductions in light of any restrictions contained in the Lease. Obviously, if the Lease provided that no post-production cost are permitted to be deducted from the royalty, then there should be no items listed in the deduction column on the Royalty Statement. To the extent that deductions were permitted, then you want to confirm that the proper deductions were taken. For example, if the Lease provided that the only deductions that could be taken were for transportation and compression, you would want to make sure that based on the key in the Royalty Statement that those were the only two deductions that were taken and deductions for dehydration and/or marketing, etc. were not taken. In addition to determining if the correct post-production deductions (if any) are being taken, you should review the amount of deductions as a percentage of the revenue received to determine if the deductions are in line with industry standards.

In addition to the aforementioned items, the conversion of a Lease from the primary term to the secondary term is also a good time to review the Lease for other Lease compliance issues which may include timber removal, surface restoration, fence installation around any compressor stations, valve sites, etc., gates on access roads, and post-drilling water testing. These are just a few examples of some surface issues that may be an issue once a lease is put into production. Obviously there can be many more and these should be reviewed on a per lease basis. ■

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