IT'S YOUR ESTATE - FALL 2021

LIVING TRUSTS

and more...

Presented by: Leslie Daff

Difference Between a Will and a Trust - and Why You Still Need a Will When You Have a Trust

No Will

Court Appoints Administrator

Probate

Intestate Heirs

Will

Executor you name

Probate

Beneficiaries you name

Revocable Living Trust

Assets

Pour Over Will

Successor Trustee you name

Trust Administration

Beneficiaries you name

What Is A Trust?

- A **Trust** is essentially a contract between a **Grantor** (also referred to as Settlor, Trustor, or Trustmaker) – the person who grants assets to a trust – and a **Trustee** – who manages the assets - for the benefit of a Beneficiary in accordance with the terms of the Trust.

The Grantor At The Outset Is All Three

- A person creating a trust is generally all three upon creation of a revocable living trust - the Grantor, the Trustee, and the Beneficiary.
  - Upon his/her incapacity, he/she is no longer Trustee - the successor Trustee steps in - but the Grantor remains the beneficiary of the trust for his/her lifetime.
  - Upon the Grantor’s death, the assets pass to the beneficiaries the Grantor named in the trust.

BASIC ESTATE PLAN

INCAPACITY

(Trust avoids Guardianship/ Conservatorship)

ASSETS

Re-title assets into your name(s) as Trustee(s) of your trust:

Real Estate

Bank and Brokerage Accounts (Non-Retirement).

Personal Property

Business Interests

Change beneficiary designations:

Life Insurance

Retirement Accounts

FINANCIAL POWER OF ATTORNEY

Agent/Attorney-in-Fact

manages assets that are not in the trust/transfers them to trust during incapacity

ADVANCE HEALTH CARE DIRECTIVE

Health Care Agent

makes medical decisions for you if you are unable to make them yourself

HIPAA AUTHORIZATION

circumvents privacy laws so your designated fiduciaries can talk with your medical providers

REVOCABLE LIVING TRUST

Contract between:

Grantor (grants assets to trust)

Trustee (manages assets in trust)

DEATH

(Trust avoids Probate)

Schedule of Assets

~~(Heggstad~~ Petition in CA)

POUR-OVER WILL

Executor/Personal Representative

pours assets that are not in your trust at death into the trust - after probate

Guardian(s) for minor children

Types of Trusts

- Revocable – Can be changed.
  - A Revocable Trust, also referred to as a Living Trust or Revocable Living Trust, is the centerpiece of a basic estate plan.
  - Not a separate entity - Grantor’s own SSN used.
  - No change in way taxes are paid.

- Irrevocable – Cannot be changed.
  - Primarily used for gifting and/or to reduce estate taxes.
  - You no longer own the assets - separate entity.
  - Compressed tax rates (top tax rate at $13,050 of income)
  - Trust Protector

Benefits of Revocable Living Trust

- Avoids conservatorship and probate.
  - Assets are distributed without court involvement (this can be a downside as well – sometimes oversight is appropriate).
  - If Grantor/Trustee becomes incapacitated, a named successor Trustee takes over management of the assets without court involvement (no conservatorship).
  - After death, assets which would otherwise be paid outright to beneficiaries can continue to be held and administered in one or more subtrusts for the entire lifetime of the beneficiary or distributed at specified age(s) or stage(s). Can protect beneficiary from himself/herself, creditors, predators, and divorce.
- Trust provisions are not made public.

Drawbacks of Revocable Living Trust

- Cost of set up
- A Revocable Living Trust is often used to avoid conservatorships at incapacity and probate at death ($56,000 for $1M house)
- Trust Administration at Death
  - Typically, 50-90% less than probate

Funding The Trust

- A critical step!
  - “Funding” your trust means retitling assets from your name(s) as individual(s) to your name(s) as Trustee(s) of your Trust. This must be done in order for your successor Trustee to be able to step in to handle your trust assets upon incapacity/death.
  - Life insurance, annuities, and retirement accounts remain titled in your own name(s). They are not retitled in your name(s) and Trustee(s) of your revocable living trust.
    - Beneficiary designations should be coordinated with your estate plan.
    - Reason assets may still go through probate

Real Property

- Deed – If sole owner or tenant-in-common owner, can transfer your interest to the trust with a deed/preliminary change of ownership report which is recorded in the county where the property is located.
  - If real property is owned in joint tenancy, the joint tenancy will have to be severed (caution: potential property tax reassessment) to transfer the interest to the trust.
- Timeshare Interests – Deed or points-based ownership
- Co-op – Attorney Opinion Letter needed to re-issue Co-op certificate.
- Out-of-state Real Property – Transferring out-of-state property should be handled by attorney in that state. Will avoid an ancillary probate in that state. Note: some states have unique rules (Hawaii).

Non-Retirement Accounts And Business Interests

Non-retirement Bank and Brokerage Accounts

1. Should be retitled in your name(s) as Trustee(s) of the trust
2. Pay-on-death (POD) or transfer-on-death (TOD) beneficiary designation only if want to keep account in sole name during lifetime
3. Can name Co-Trustee as to one or more accounts
4. Can give someone power of attorney over trust account
5. Household checking account
6. Checks – Do not need trust name on checks

Business interests – Interest in sole proprietorship, corporation, professional corporation, limited liability company, and/or general or limited partnership

1. Assign to trust
2. Change title on books and records
3. Do not change title on business accounts – keep them in the name of the business

Other Assets

<u>Safe Deposit Boxes</u> - Re-title in name of trust and/or add a joint owner

<u>Promissory Notes</u> – Assign to trust

<u>Paper Savings Bonds</u> – Re-title in name of trust (treasurydirect.gov)

<u>Cars and Vessels</u> – DMV Affidavit for Transfer without Probate California Titled Vehicles and Vessels (not documented by the U.S. Coast Guard)

<u>Mobile Homes</u> (California Department of Housing and Community Development www.hcd.ca.gov/manufactured-mobile-home/registration-titling)

<u>Tangible Personal Property</u> – Assign to trust

If Assets Are Not In Trust

- **Power of Attorney**
- **Small Estate Affidavit**
- **Heggstad or Ukkestad Petition** can avoid full probate at death.
- **Pour Over Will** can be used as a "safety net" to "pour" assets into the living trust so they can be distributed according to the trust's terms.

Information Needed to Create a Trust

- Most attorneys use a worksheet to obtain information:
  - Names and name of trust
  - Asset information for tax planning and trust funding
    - Not SSNs or account numbers
  - Successor Trustees, in order, who will:
    - Handle financial affairs if you are incapacitated
    - Marshall assets, pay taxes, distribute your assets at death, etc.
  - Definition of Incapacity (one physician, two physicians, physician and spouse, family panel)
  - Beneficiaries (at the first death, if any, and at the second death)
  - Remote contingent beneficiaries

Gift and Estate Tax

- Generally, you are subject to gift tax whenever you give property to individuals.
- Three types of gifts are exempt from gift tax:
  - Generally, gifts to spouse and charities
  - Gifts to any individual of up to $15,000 annually
  - Direct payments for tuition or medical care for any individual
- Federal Gift/Estate Tax Exclusion: $11,700,000 during lifetime and/or at death in 2021 (adjusted for inflation - $11,580,000 in 2020)
  - 40% top tax rate
  - No California estate tax

Biden's Tax Proposals

- Eliminate stepped up cost basis at death
- Reduce the estate tax exemption
- Increase federal estate tax rate
- Reduce/eliminate discounting techniques
- Reduce annual gift-tax exclusion

Capital Gains Tax

- Purchase home for $180,000 and spend $20,000 on improvements. Basis is $200,000.
- Sell home 30 years later for $2,000,000.
- Capital gain is $1,800,000 and subject to capital gains tax.
  - $250,000 exemption for primary residence (2 out of 5 years) – both husband and wife

Basis Adjustment (Step Up)

- Joint Tenants – partial step up at first joint tenant’s death
- Community Property – full step up at first spouse’s death
- Solely Owned
  - Gift during life – Donor’s basis
  - Inherit at death – full step up
- From irrevocable trust – no step up

Marital Sub-trusts

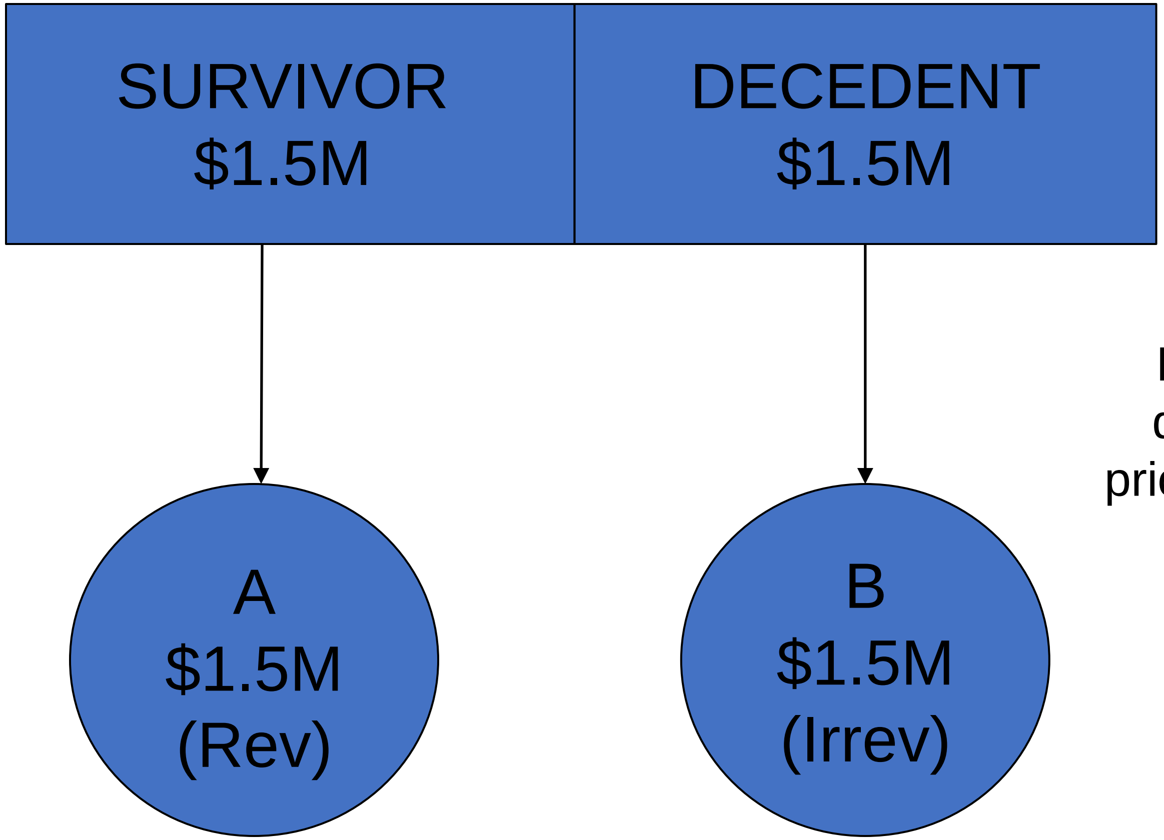
- **A Trust** – Survivor’s Trust (Revocable)
- **B Trust** – Also referred to as Bypass Trust, Credit Shelter Trust, and Exemption Trust – the maximum it can hold is the deceased spouse’s Applicable Exclusion Amount ($11,700,000 in 2021)
- **C Trust** – Also referred to as QTIP Trust or Marital Trust
  - To control decedent’s property after death

Married Couples – First Death

- Surviving spouse's share (1/2 of CP and all his/her SP) to revocable A Trust to avoid probate at second death
- Deceased spouse's share (1/2 of CP and all his/her SP) to:
  - Revocable A trust
  - One or more irrevocable (B and C) sub-trusts; and/or
  - Descendants or other beneficiaries

Married Couple First Death –Trusts Drafted In or Prior to 2010

$3M Community Property Estate in 2005
($1.5M Estate Tax Exemption)



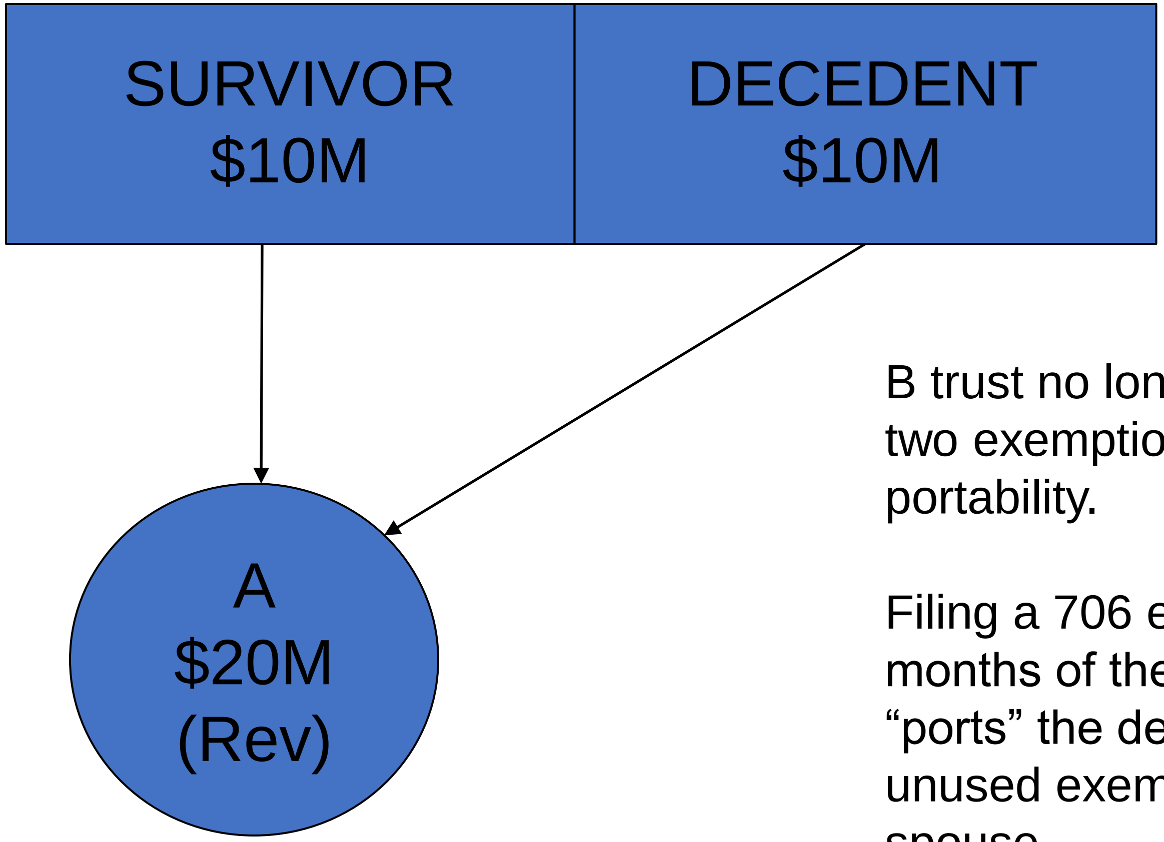
Many trusts drafted in or prior to 2010 are AB or ABC trusts

Portable Exemption

- Surviving spouse can elect to claim the deceased spouse's unused exemption.
- In order to make this election a timely Form 706 estate tax return must be filed.

Married Couple First Death - 2021

$20M Community Property Estate
($11.7M Estate Tax Exemption - Portability)

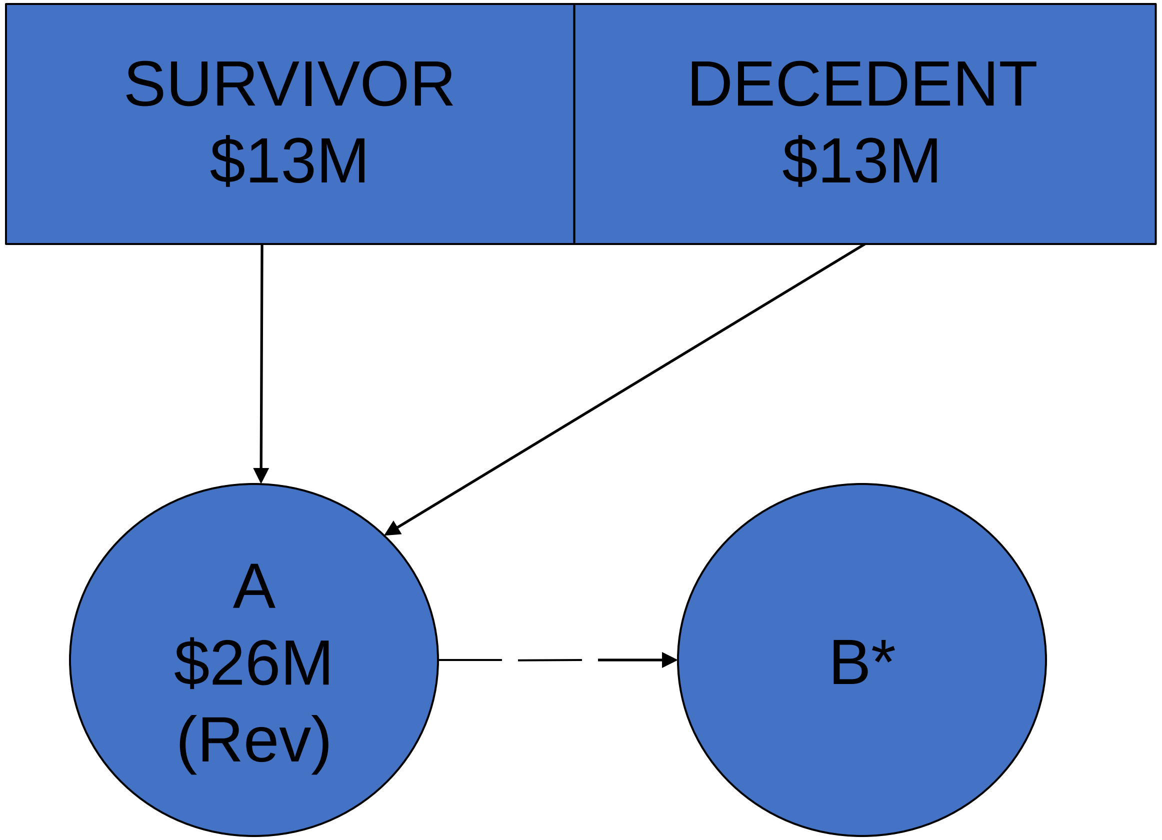


B trust no longer needed to pass two exemptions because of portability.

Filing a 706 estate return within 9 months of the first spouse's death "ports" the deceased spouse's unused exemption to the surviving spouse.

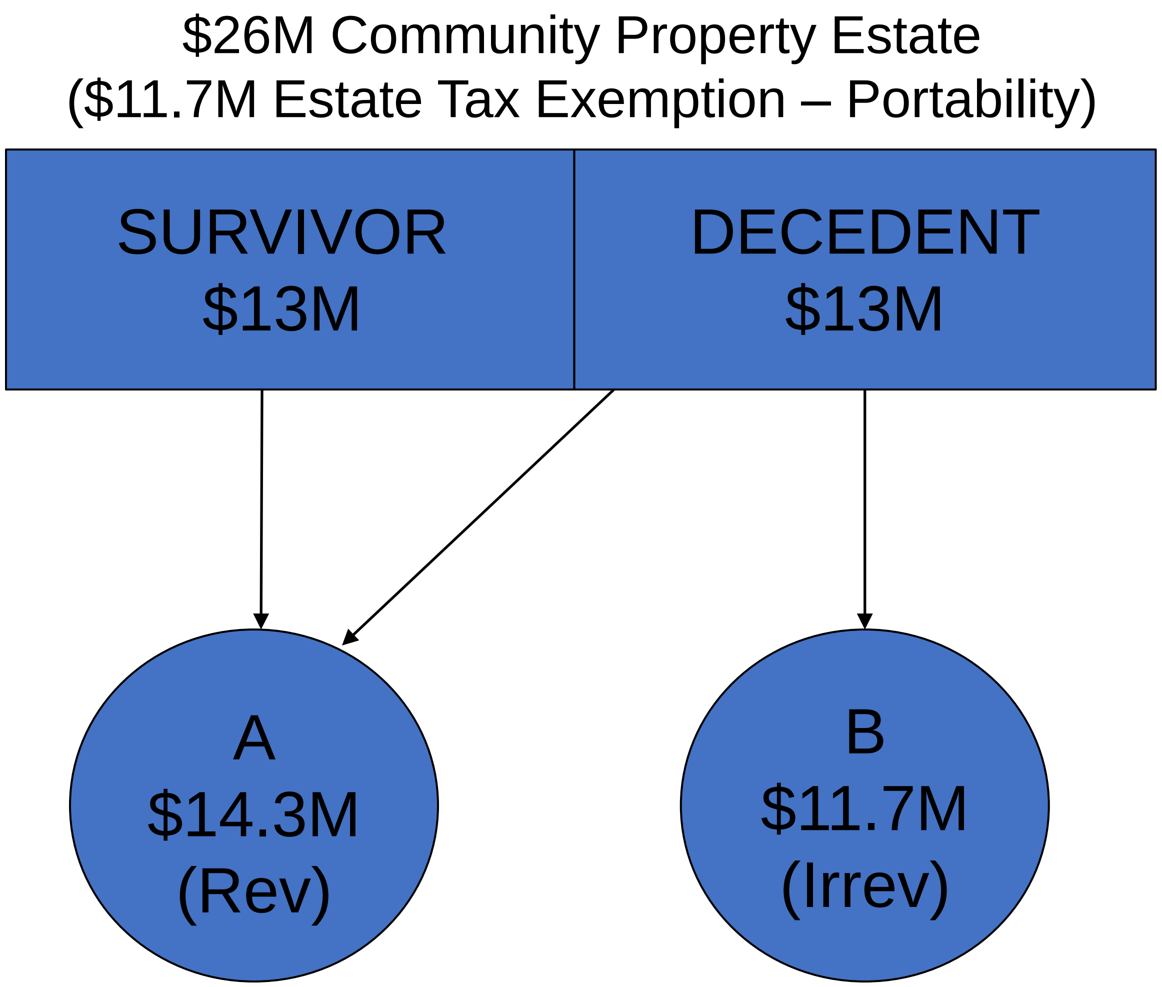
Survivor/Disclaimer Trust (Optional B Trust) - 2021

$26M Community Property
($11.7M Federal Estate Tax Exemption)



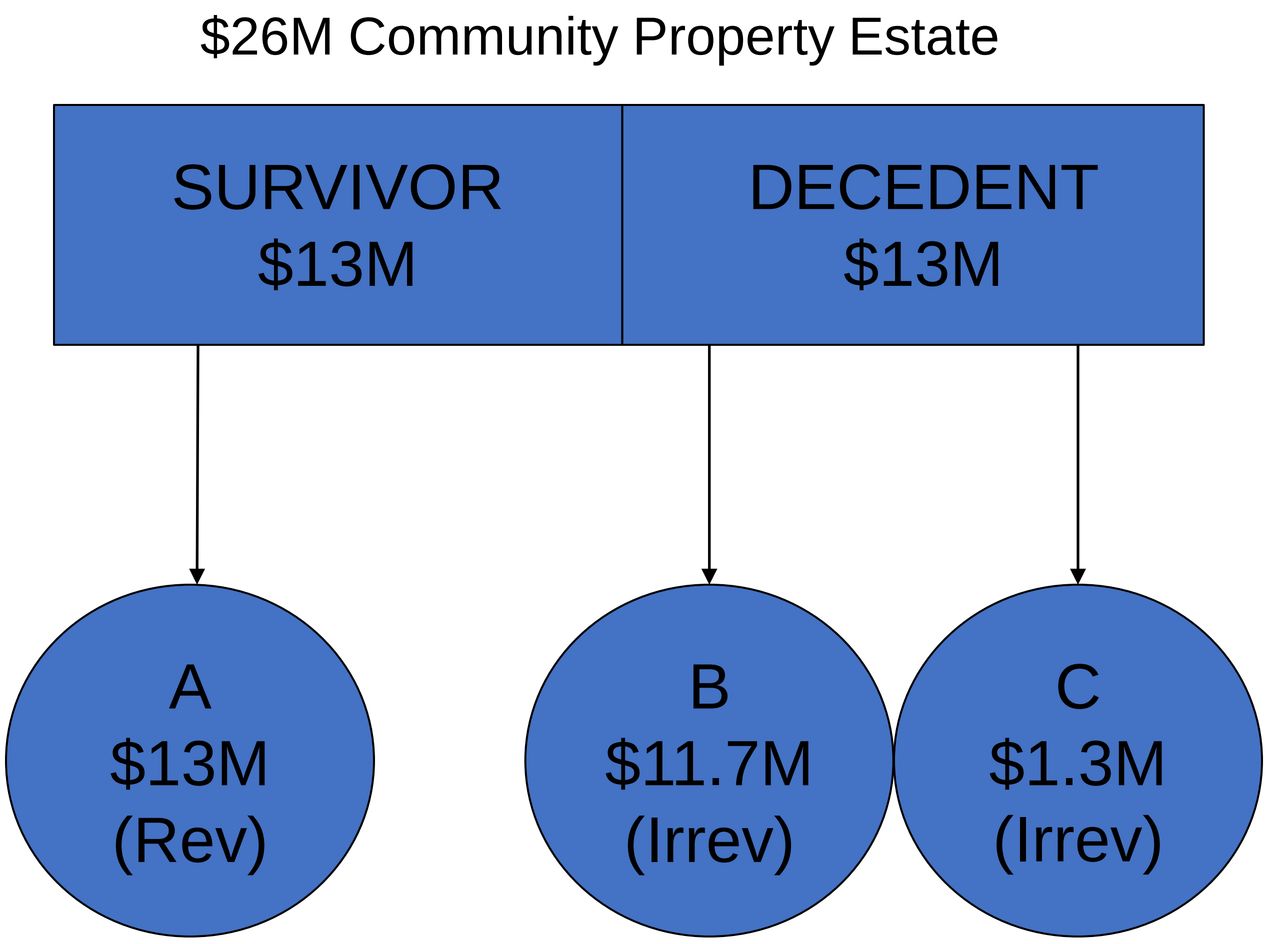
*But better to have optional disclaimer trust so survivor can disclaim up to $11.7M to B trust if desired - future appreciation passes tax-free but lose second step up in basis.

AB Trust (Mandatory B Trust) - 2021



If estate may exceed $23.4M, concerned about missing disclaimer deadline, and/or want control, can mandate B trust – appreciation passes tax-free but lose second step up in basis.

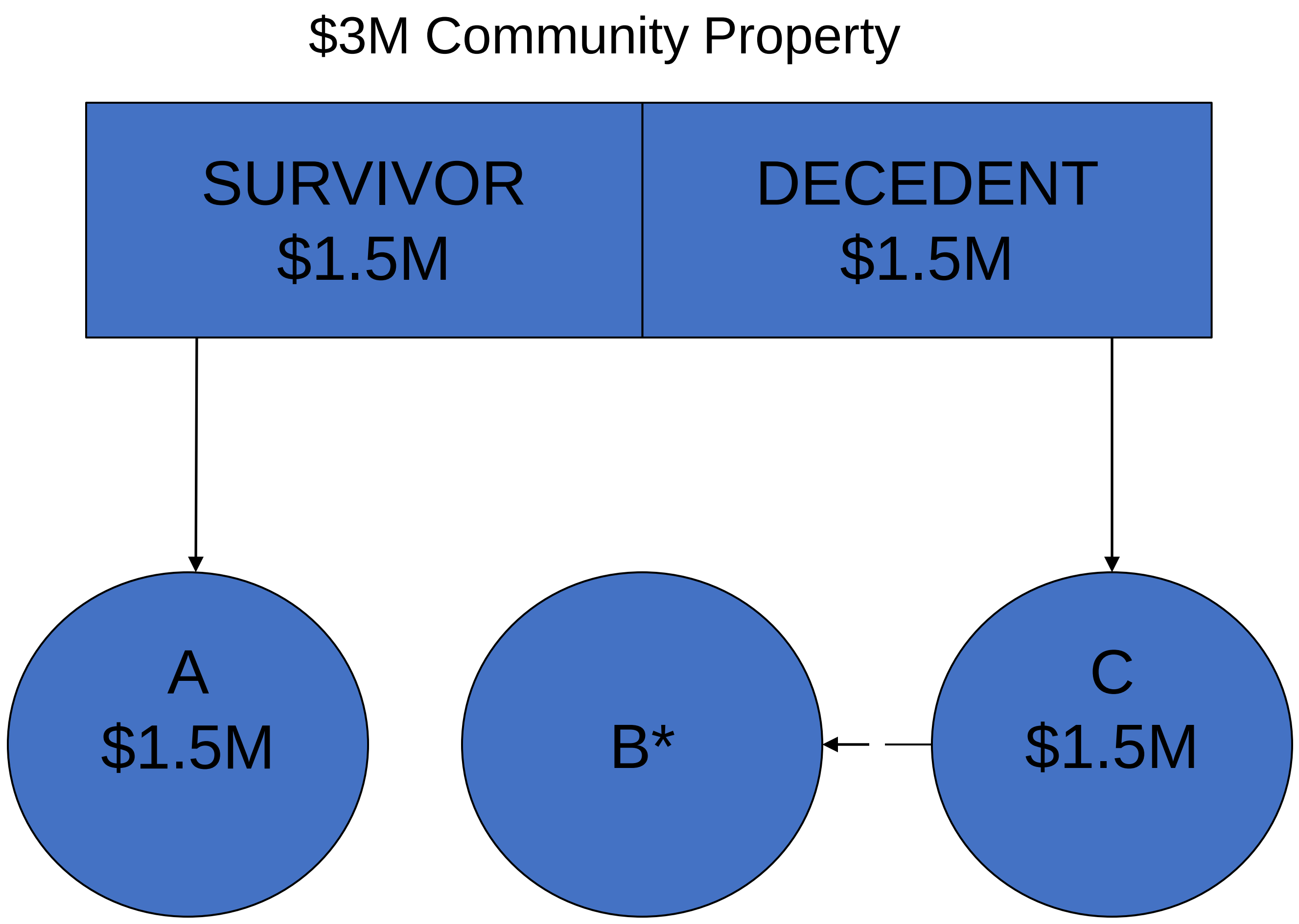
ABC Trust (Mandatory B and C Trusts) - 2021



B trust can hold up to $11.7M of deceased spouse's assets.

Excess to C trust. (If control not desired, excess could go to A trust.)

AC Trust - 2021



For control and a second step up in basis.

*Can disclaim up to $11.7 to B trust for appreciation to pass tax-free but will lose second step up in basis.

Sub-Trust Considerations – Simplicity or Control

- Sub-trust administration – allocate assets between sub-trusts, obtain taxpayer ID number for irrevocable trust, and prepare additional tax return (1041) for irrevocable trust.
  - Determine whether to give surviving spouse a limited testamentary power of appointment (e.g., among joint descendants, or among descendants and charities).
  - Note, generally in funding sub-trusts, the primary residence is allocated to the A trust to preserve the $250,000 capital gains exclusion for the surviving spouse (can also use deceased spouse’s exemption for 2 years).

Considerations for Distributions to Children and Other Beneficiaries

- Outright
- In stages
  - Distributions for health, education, maintenance, and support:
    - At age 25, one-third outright
    - At age 30, one-half of remaining balance outright
    - At age 35, remainder outright
- Lifetime Trusts
  - Distribution Trustee
  - Beneficiary-controlled trusts (descendant can resign, remove, and replace Trustees of his/her own trust)
  - Tax ID number
  - Compressed tax rates
- Parent-Child Exclusion

Other Trusts (Standalone or within Revocable Living Trust)

- **Supplemental (Special) Needs Trust for beneficiary with:**
  - Mental or physical incapacity
  - Governmental assistance is available
  - Inheritance would mean no governmental assistance
  - Limited rights to use preserves trust assets from governmental levy
  - A standalone trust allows others to contribute
- **Pet trusts**

Qualified Domestic Trust

- Non-U.S. citizens
- If one or both spouses are not citizens of the United States, a qualified domestic trust (QDOT) must be used to take advantage of a special marital deduction similar to the unlimited marital deduction used by couples who are both citizens.
  - Properly structured, a QDOT can postpone estate taxes until the death of the second spouse.
  - Special restrictions apply

Irrevocable Life Insurance Trusts (ILIT)

- Although life insurance proceeds constitute tax-free income, they are subject to estate tax.
  - However, a special trust called an Irrevocable Life Insurance Trust (ILIT) can be created to hold the life insurance policy.
- An ILIT is an IRS-approved means of removing your life insurance proceeds from your taxable estate while still having the proceeds available to provide for your spouse, children, or other beneficiaries according to your desires. Gifts made each year to the ILIT to pay the policy premiums can be exempt from gift tax.
  - 3-year rule

How ILITs Work

- Grantor of ILIT sets up Irrevocable Trust (ILIT) naming another person/entity as Trustee.
- The Trust/Trustee is named the owner of the life insurance policy and the ILIT is named the beneficiary.
  - Trustee obtains a new taxpayer ID number for the ILIT and sets up an ILIT bank account under the new taxpayer ID.
- Grantor provides the account with a “gift” with which to pay life insurance premiums.
- Trustee notifies beneficiaries (“Crummey” notice) that a gift has been made to the ILIT and they have 30 days to take the gift (required to make it a gift of a present interest), otherwise it will be used to pay the premium.
  - Beneficiaries decline to take the present gift.
- At death, the life insurance proceeds pass free of estate tax.
  - ILIT can be used to pay estate taxes to keep an otherwise taxable estate intact.

Additional Trusts for Larger Estates

- Charitable Remainder Trusts (CRT)
- Charitable Remainder Annuity Trust (CRAT)
- Charitable Remainder Unitrust (CRUT)
- Grantor Retained Annuity Trust and Grantor Retained Unitrusts (GRAT or GRUT)
- Qualified Personal Residence Trust (QPRT)
- Charitable Lead Trust (CLAT or CLUT)
- Irrevocable Trusts for Children/Grandchildren (Crummey Trusts)
- Intentionally Defective Grantor Trusts (IDGT)

Family Limited Partnership and Limited Liability Company

- The family limited partnership (FLP) and family limited liability company (FLLC) are sophisticated estate planning devices.
- By transferring income-producing capital assets (i.e., rental property) into an FLP or FLLC, the value of the assets can be discounted up to 30% or more based on factors such as the lack of marketability of or minority interest in the partnership shares.
- Gifting fractionalized FLP and FLLC interests in assets can be an effective way to make maximum use of an individual's federal transfer tax applicable exclusion amount during life.
  - Caution: Must have business purpose (not used for residence) – not just tax-avoidance, observe formalities.

Asset Protection

A cost/benefit analysis:

- Insurance
- Entities (e.g., Limited Liability Company)
- Domestic Asset Protection Trusts (for residents of states such as Nevada, Alaska, etc.)
- Offshore Asset Protection Trusts

Trust Administration

A. Lodge Original Will with Probate Court
B. Notify Health Department
C. Send Formal Notices to Beneficiaries
D. Obtain Tax ID number(s)
E. Fund Sub-trusts, as appropriate
    1. "Busting" the B Trust
        (1) Petitioning the court
        (2) Provisions of trust may permit with consent of remainder beneficiaries
F. Retitle Non-Retirement Financial Accounts to Name of Successor Trustee of trust
G. File Affidavit Death Trustee with Recorder and File Statement of Death of Real Property Owner with Assessor
H. File property tax exclusion paperwork with Assessor, as appropriate
I. File Statement of Change in Control and Ownership of Legal Entities with Board of Equalization
J. File decedent's final 1040 due in April the year after death and trust returns (1041) due annually thereafter until trust administration is finalized
K. To "port" exemption to surviving spouse, or for taxable estates, file 706 tax return (or 6-month extension) within 9 months of death. Payment due within 9 months.

Thank you!

Please feel free to call or email if you have any questions:

Leslie Daff
(949) 497-5056
LDaff@estateplaninc.com