It's Your Estate – Fall 2023

Wills & Trusts

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What is a Will?

A Will is a legal document that allow you to:

- direct the distribution of your assets at death
- nominate guardians for minor children
- nominate an Executor to administer your estate at death
- avoid intestate succession

Types of Wills

- Holographic
  - Material provisions must be in testator’s handwriting
  - Must be signed but does not need to be dated or witnessed
- Statutory
  - Statutory Form can be filled in but not altered
  - Must have two witnesses
- Typewritten
  - Must have two witnesses

No Will vs. Will

No Will

Administrator (and Guardian for minor children, if necessary) appointed by Court

Probate

Intestate Heirs

Will

Executor (and Guardian, if necessary) you name

Probate

Beneficiaries you name

Probate

Probate is the court-supervised process of distributing a decedent's assets after death

The administrator/executor and the attorney are each entitled to statutory fees based on the gross value of the estate (not net of mortgages or indebtedness)

Note: The title of "administrator" is used when someone dies without a Will, the title of "executor" is used when someone dies with a Will, and "personal representative" refers to either

Probate Fees and more…

Statutory Fees:

4% on first $100,000
3% on next $100,000
2% on next $800,000
1% on next $9 million

- $1 million gross estate - $23,000 x 2 = $46,000
- $5 million gross estate - $63,000 x 2 = $126,000

Also:

- Fees for court, filing, and probate referee to appraise assets
- Bond
- Potential for extraordinary fees
- Probate can take 18 months or more to complete
- Terms of Will, beneficiaries, and probate assets are public

But: Oversight may be warranted for complex/conflicted estates

Avoiding Probate

- **Pay-on-death/transfer-on-death designations (bank/brokerage accounts)**
- **Beneficiary designations (life insurance/retirement accounts)**
- **Titling (e.g., joint tenancy) - Drawbacks:**
  - Adding a child to title to real property is a gift if over $17,000 in any given year and exposes the property to sale by child, child's creditors, and child's divorce
  - Child loses full step-up in cost basis he/she would have otherwise received if he/she inherited it at death instead
  - Adding child to account title so he/she can easily manage it will result in the account going only to that child
- **Revocable Living Trust**

Summary Probate Procedures

- Small Estate Set Aside (PC 6600) – can be used when net value of real and personal property is less than $95,325
- Small Estate Affidavit (PC 13100) – can be used when personal property is less than $184,500
- Petition to Determine Succession to Real Property (PC 13150) – can be used when real property is less than $184,500

Summary Probate Procedures (cont.)

- Affidavit to Transfer Real Property of Small Value (PC 13200) – can be used when real property is less than $61,500
- Collection of Salary (PC 13600) – Spouse can use affidavit to collect up to $18,450 net in salary and unused vacation time owed to deceased spouse from deceased spouse's employer
- Spousal Property Petition (PC 13650) – can be used to pass title to the surviving spouse and to determine that the property is already owned by the surviving spouse (as community property)

Assets

Pour Over Will

Revocable Living Trust

Successor Trustee

you name

Trust Administration

Beneficiaries
you name

What Is A Trust?

A **Trust** is essentially a contract between:

a **Grantor, Settlor**, **Trustor**, **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

Creating a Living Trust

- The creator of a living trust:
  - Is all three at inception – the Grantor, the Trustee, and Beneficiary
  - The Grantor manages his/her assets as Trustee and is the beneficiary for his/her entire lifetime until he/she becomes incapacitated or dies and the successor Trustee steps in
  - Upon the Grantor’s death, the assets pass to the beneficiaries the Grantor named in the trust

Basic Estate Plan

INCAPACITY

(Trust avoids Conservatorship)

FINANCIAL POWER OF ATTORNEY

Agent/Attorney-in-Fact

ADVANCE HEALTH CARE DIRECTIVE

Health Care Agent

HIPAA AUTHORIZATION

Schedule of Assets

(Heggstad Petition)

REVOCABLE LIVING TRUST

Contract between:

Grantor/Settlor/Trustor/Trustmaker (grants assets to trust)

Trustee (manages assets in trust)

DEATH

(Trust avoids Probate)

POUR-OVER WILL

Guardian

Executor/Personal Representative

Types of Trusts

- **Revocable Trust** – Can be changed. A Revocable Living Trust is the centerpiece of a basic estate plan.

- **Irrevocable Trust** – Typically cannot be changed. Can be used for gifting and/or to reduce estate taxes (assets are no longer owned by Grantor).
  - Can be modified or terminated *during* Grantor's lifetime if the Grantor and all beneficiaries agree, and *after* Grantor's death with court approval.
  - Compressed tax rates – Irrevocable trusts pay tax at the top tax bracket of 37% when undistributed taxable income is $14,450, whereas individuals pay at the top tax bracket when taxable income is $578,125 and married couples at $693,750
  - Revocable Trusts become irrevocable upon Grantor's death
  - Form 1041
  - Trust Protector

Benefits of Revocable Living Trust

- Avoids conservatorship at incapacity and probate at death.
- Assets are distributed without court involvement.
- If Grantor/Trustee becomes incapacitated, a named successor Trustee takes over management of the assets without court involvement - no conservatorship.
- After death – no probate. Assets which would otherwise be paid outright to beneficiaries can continue to be held and administered in one or more sub-trusts for the lifetime of a beneficiary or distributed at specified age(s) or stage(s). Can protect beneficiary from creditors, predators, and divorce.
- Transferring out-of-state property to the trust will avoid ancillary probates in other states
- Trust provisions are not made public.

Drawbacks of Revocable Living Trust

- Cost to set up.
- No oversight.
- Trust Administration at death, but typically 50-90% less than probate.
- Common fallacies about a Revocable Living Trust:
  - It provides asset protection – No, not for the Grantor of a self-settled trust, though the Grantor can build in asset protection for third parties - beneficiaries – who inherit in trust after the Grantor's death.
  - It has separate tax ID number - No, the tax ID number is the Grantor's SSN until death. Taxes are paid exactly as they were before the trust was created.

Funding the Trust – A Critical Step!

"**Funding**" a trust means assets must be re-titled from your name as an individual to your name as Trustee of your trust so your successor Trustee can step in to manage them at your incapacity and distribute the assets in accordance with the terms of your trust at death.

Acquiring new assets or disposing of assets after you create your trust does not ordinarily affect the terms of your trust. You must remember to take title to new assets in the name of your trust.

Exceptions: Retirement Plans and Life Insurance

Retirement plans and **life insurance** (except life insurance in an ILIT) remain titled in your own name during your lifetime and are not retitled in your name as Trustee of your trust. These assets pass by beneficiary designation and thereby avoid probate, assuming you have a named beneficiary who survives you and you do not name your "estate" the beneficiary.

You can name individuals, entities, or your trust as beneficiaries, but beneficiary designations must be coordinated with your overall estate plan and, particularly for retirement plans, are best handled with the advice of an attorney.

Trust as Beneficiary of Retirement Plans and Life Insurance

(Naming beneficiaries of **retirement plans** is addressed in a separate workshop.)

If there are no creditor issues or other reasons not to have **life insurance proceeds** flow through the trust at death, naming the trust the beneficiary of life insurance:

- avoids probate if all named beneficiaries die before claiming proceeds.
- can fund trust sub-trusts at death.

Real Property, Timeshares, and Co-ops

- **Real Property** – Sole owners or tenant-in-common owners can transfer their interests to the trust with a deed/preliminary change of ownership report 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 to the trust should be handled by an attorney in that state, which will avoid an ancillary probate in that state. Note: some states have unique rules (HI).

Bank and Brokerage Accounts

Bank and Brokerage Accounts (non-retirement/non-business):

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

Business Interests

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

- Sign an assignment to trust.
- Change title on books and records.
- Do not change title on business bank accounts - keep them in the name of the business.

Other Assets

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

Promissory Notes – Sign assignment to trust.

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

Cars and Vessels (not documented by U.S. Coast Guard) – Pass free of probate using DMV Affidavit for Transfer without Probate California Titled Vehicles and Vessels

Vessels Documented by the U.S. Coast Guard – Re-title in name of trust with U.S. Coast Guard Transfer of Ownership Form CG-1258.

Other Assets (cont.)

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

Tangible Personal Property – Sign general assignment to trust.

- May dispose of personal effect by Personal Property Memorandum.

If Assets Are Not In Trust

- **Power of Attorney** – Agent can transfer assets to trust before Grantor's death.
- **Summary Probate Procedures** - Small Estate Affidavit, for example.
- **Heggstad/Ukkestad Petition** – Court petition process to avoid full probate at death.
- **Pour Over Will** – Final safety net to pour assets into the trust so they can be distributed according to the trust's terms – *after* probate.

Information Needed to Create a Trust

- **Names** – Use name most often used to title accounts, typically first name, middle initial, and last name (can add "akas" in your documents).
- **Name of Trust** - **Three** components to trust name – 1) name(s) of Trustee(s), 2) name of trust, and 3) date of trust.
- **Asset information** for tax planning and trust funding.
  - SSNs and account numbers not needed
- **Successor Trustees** - in order - who will:
  - Handle financial affairs if you are incapacitated.
  - Marshall assets, pay taxes, distribute your assets at death.
  - Friends, family members, CPA, private fiduciary, corporate Trustee.
  - Serve individually, jointly, by majority.

Information Needed to Create a Trust (cont.)

- **Definition of Incapacity** (one physician, two physicians, physician and spouse or family member)
  - Special provisions regarding distributions during incapacity
- **Beneficiaries**
  - At the first death, if any for married couples, and at the second death
  - Back-up beneficiaries
  - Manner of distribution – outright or in trust (terms: ages, stages, incentive provisions)
  - Adjustments for advancements
- **Remote Contingent Beneficiaries**
  - Default to heirs at law, or to others, or charities

Gift Tax

- Generally, you are subject to gift tax whenever you give assets to individuals.
- Three types of gifts are exempt from gift tax:
  - Generally, gifts to spouse and charities
  - Gifts to any individual of up $17,000 in 2023
  - Direct payments for tuition or medical care for any individual

Estate Tax

- Federal Gift/Estate Tax Exclusion:
  - $12,920,000 in 2023
  - To revert to $5,000,000, adjusted for inflation - expected to be roughly $7,000,000 - in 2026, if the law is not extended or changed
    - 40% top tax rate
    - No California estate tax

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/$500,000 exemption for primary residence (2 out of 5 years).

Basis Adjustment – Step Up or Step Down

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

Marital Sub-trusts:

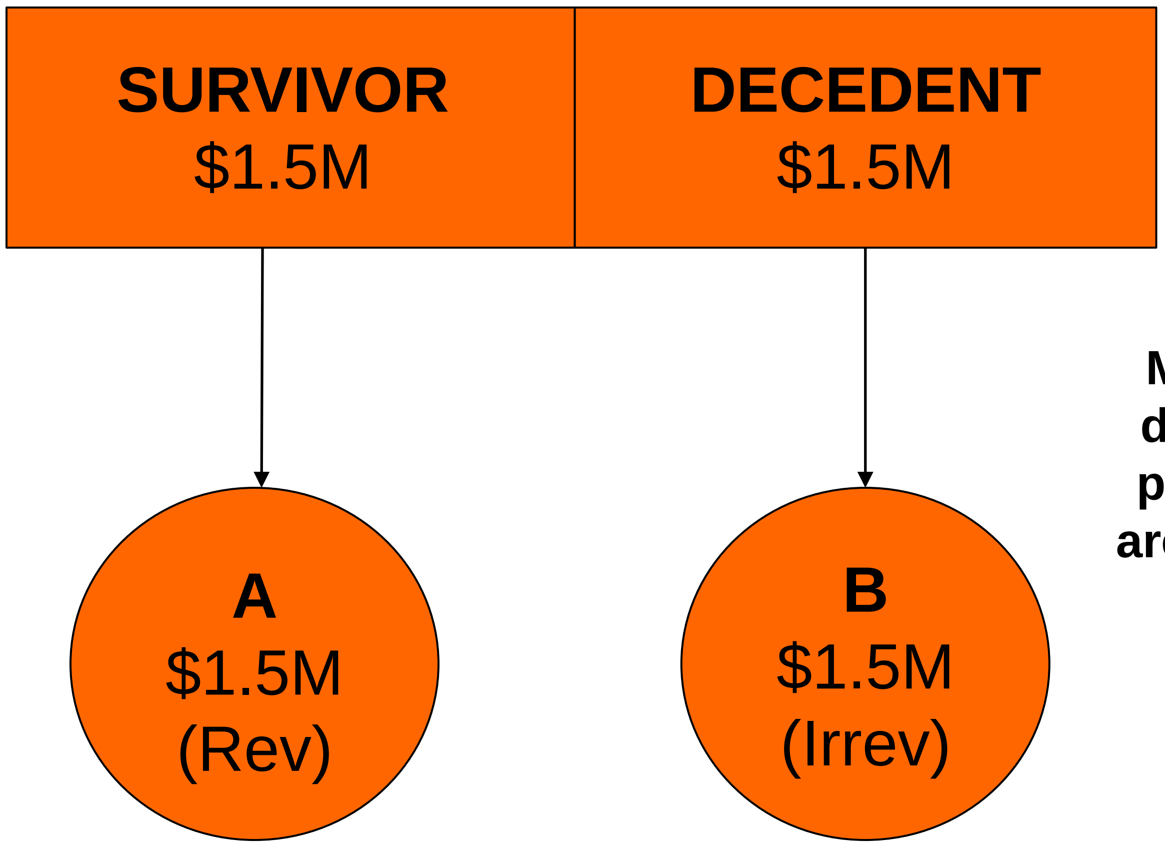
- **A Trust** – Survivor's Trust (Revocable)
- **B Trust** – Also referred to as Bypass Trust, Credit Shelter Trust, and Exemption Trust – the maximum it can hold is the deceased spouse's Applicable Exclusion Amount ($12,920,000 in 2023)
- **C Trust** – Also referred to as a QTIP Trust or Marital Trust
  - 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 - 2023

$8M Community Property Estate
($12.92M Estate Tax Exemption - Portability)

SURVIVOR $4M	**DECEDENT** $4M

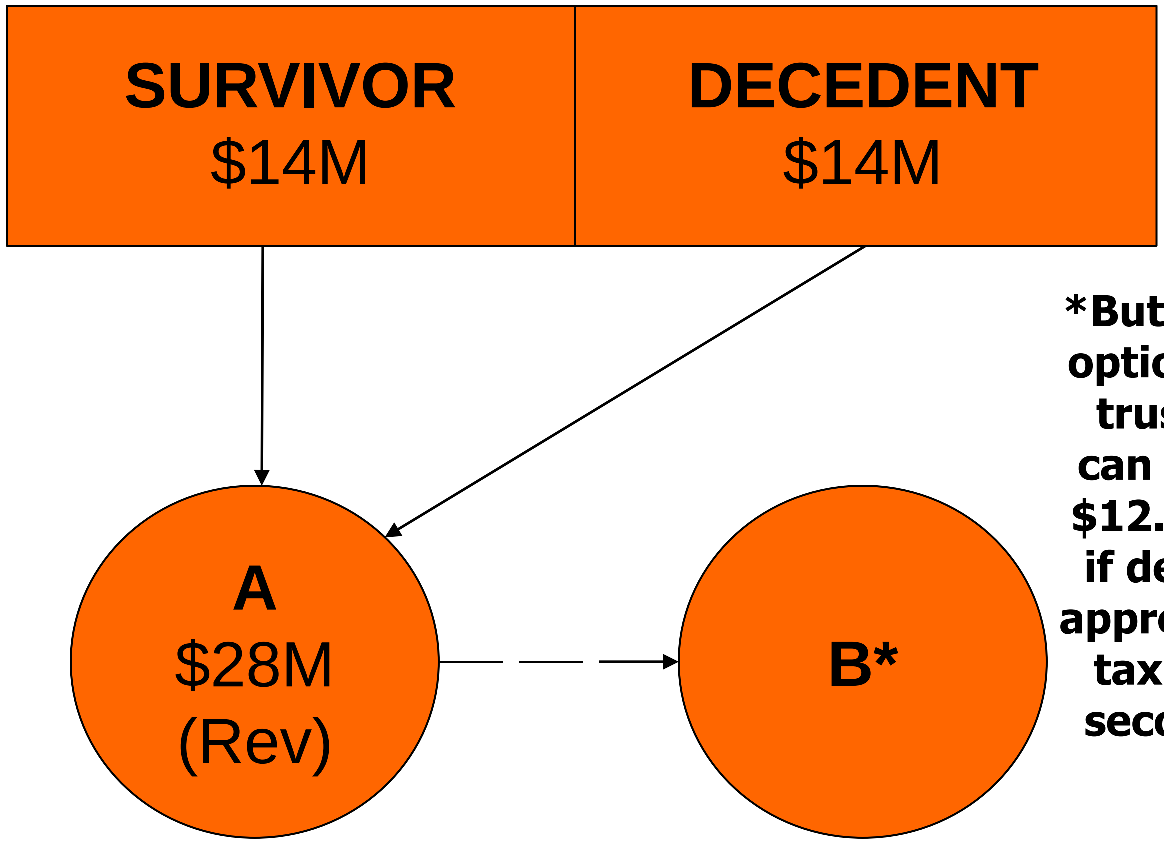
A
$8M
(Rev)

B trust not needed to pass two exemptions because of portability.

Filing a timely 706 estate return "ports" the deceased spouse's unused exemption to the the surviving spouse.

Survivor/Disclaimer Trust (Optional B Trust) - 2023

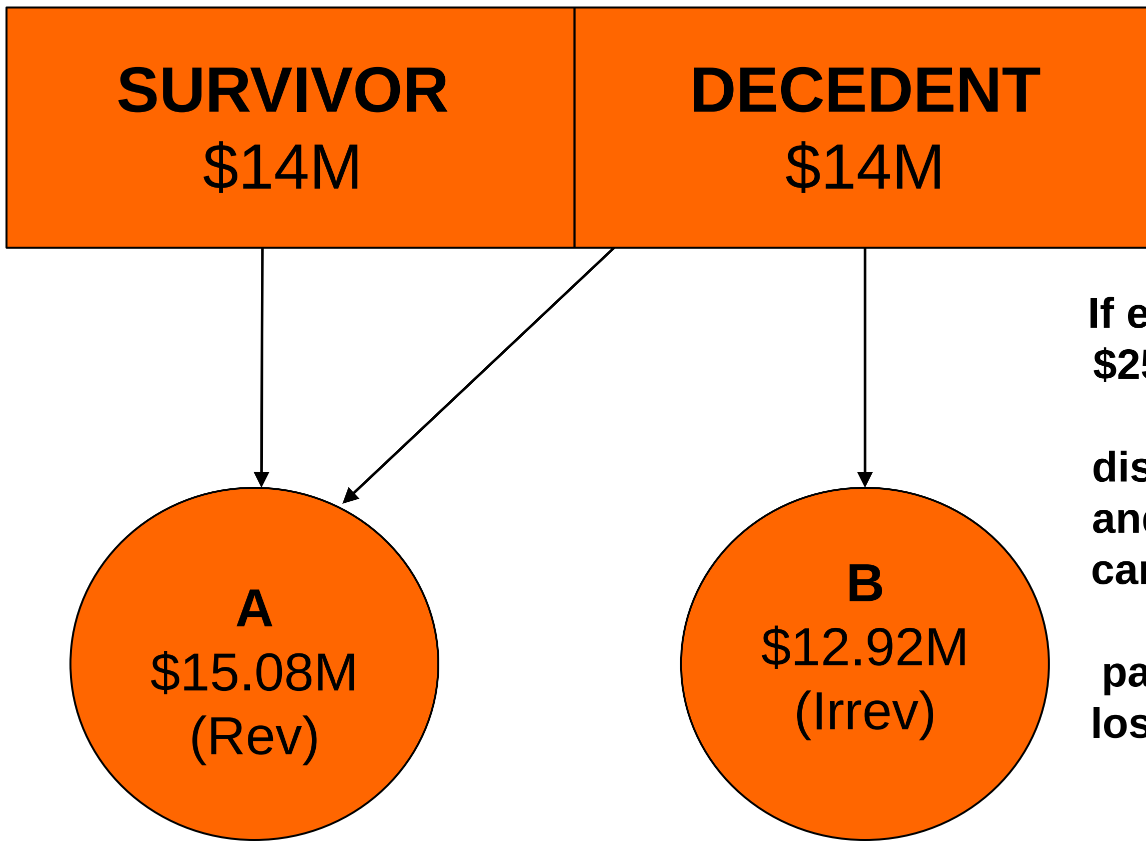
$28M Community Property
($12.92M Federal Estate Tax Exemption)



***But better to have optional disclaimer trust so survivor can disclaim up to $12.92M to B trust if desired - future appreciation passes tax-free but lose second step up in basis.**

AB Trust (Mandatory B Trust) - 2023

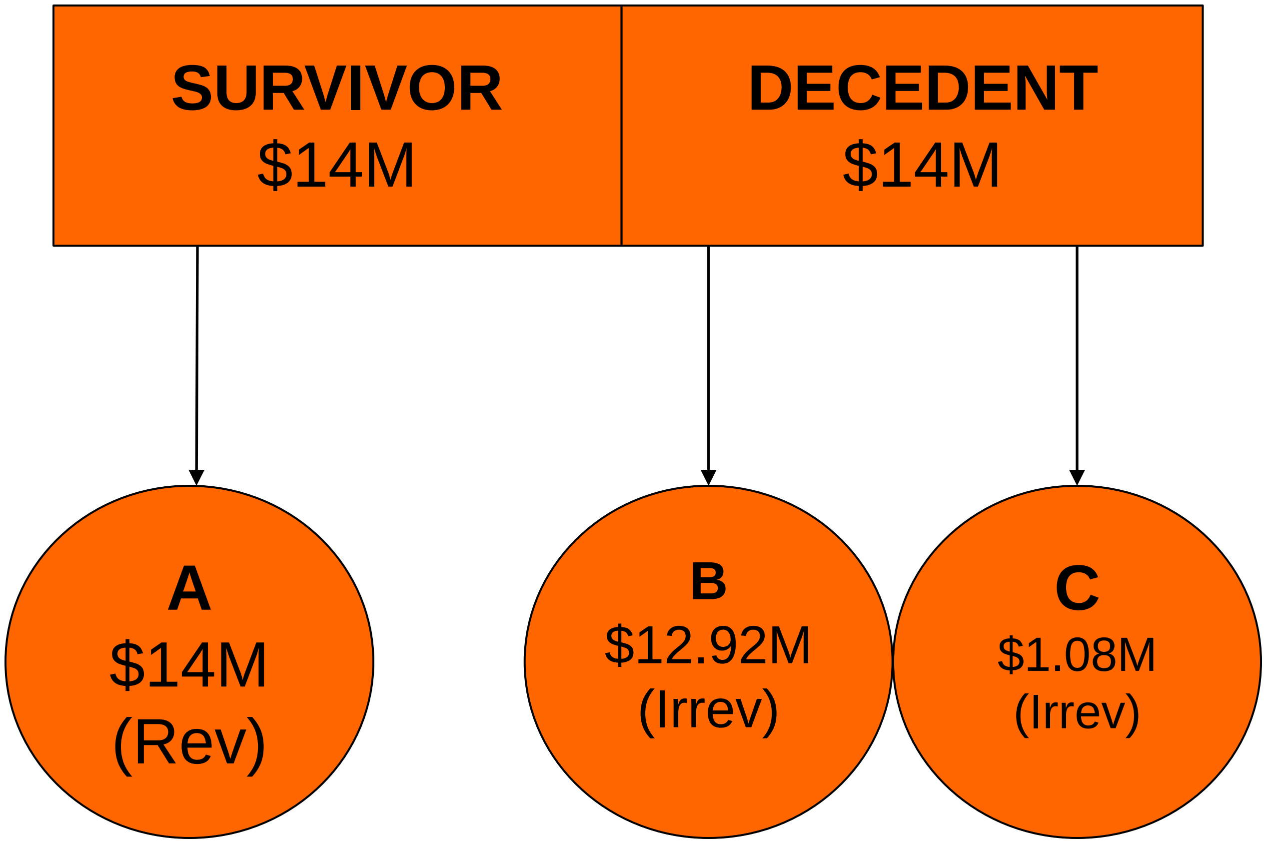
$28M Community Property Estate
($12.92M Estate Tax Exemption – Portability)



If estate may exceed $25.84M, 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) - 2023

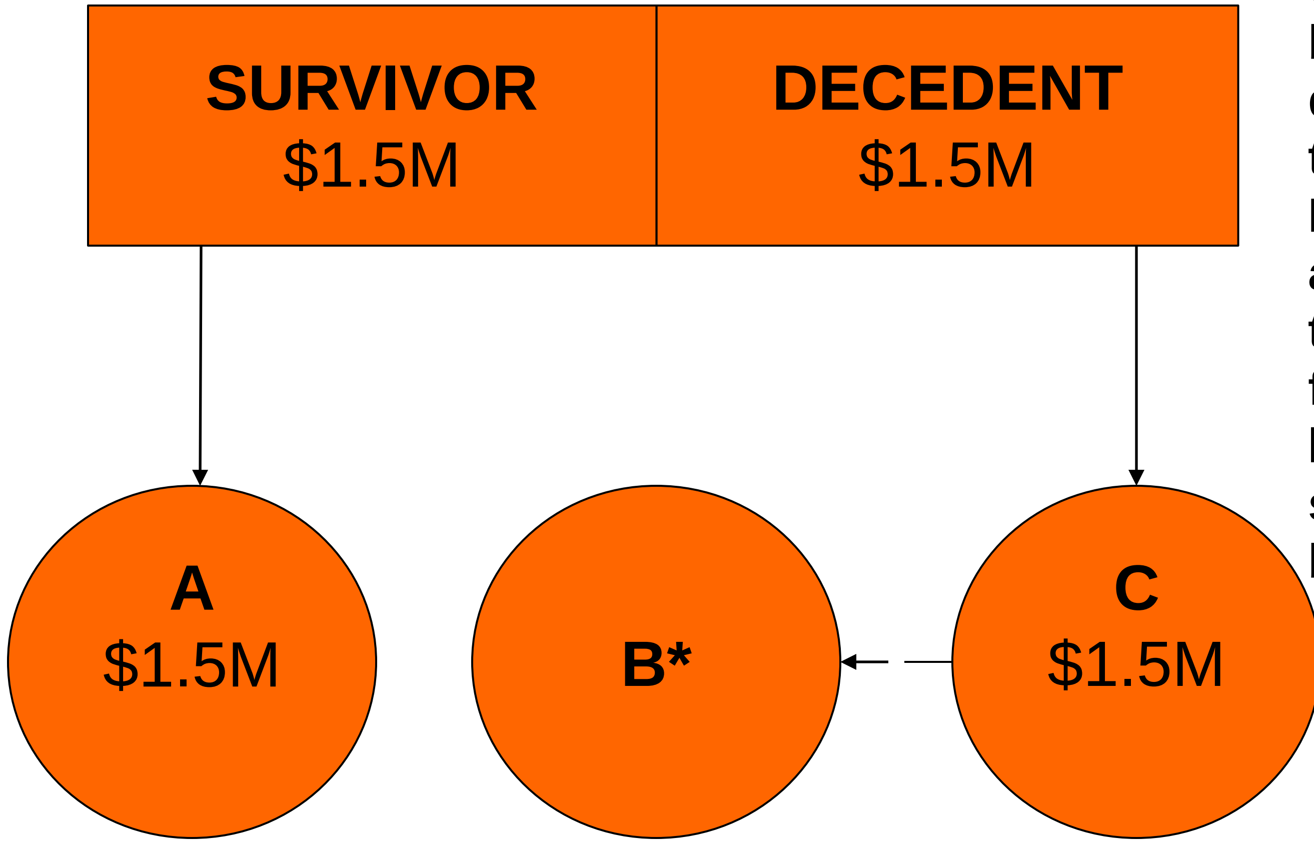
$28M Community Property Estate



B trust can hold up to $12.92M of deceased spouse's assets. Excess to C trust. (If control not desired, excess could go to A trust.)

AC Trust - 2023

$3M Community Property



For control and a second step up in basis. *Can disclaim up to $12.92M to B trust for appreciation to pass tax-free but will lose second step up in basis.

Sub-trust Considerations for Spouses – Simplicity or Control

- Sub-trust administration – Allocate assets between sub-trusts, obtain tax ID number for irrevocable trust, and prepare Form 1041 annually 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, allocation determined after the first death (e.g., primary residence typically allocated to the A trust to preserve $250,000/$500,000 capital gains exclusion.

Considerations for Distributions to Children and Other Beneficiaries

- Outright
- At ages/stages:
  - Distributions for health, education, maintenance, and support – Example: 1/3 at age 25; ½ of remainder at age 30; and remainder at 35
- Lifetime Trusts
  - Distribution Trustee
  - Beneficiary-controlled trusts – beneficiary can be Trustee of his/her own trust at ages/stages, and can resign, remove, and replace Trustees
  - Tax ID number
  - Form 1041
- Parent-Child/Grandchild Property Tax Exclusion (Prop 19)

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

- If one or both spouses is/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 - One Trustee must be a U.S. Trustee, and if the value exceeds $2 million, U.S. Trust Company or bond required.

Irrevocable Life Insurance Trusts (ILIT)

- Although life insurance proceeds are 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 policy.
- An ILIT is an IRS-approved means of removing life insurance proceeds from your taxable estate while still having the proceeds available to provide for your spouse, children, or other beneficiaries. Gifts made each year to the ILIT to pay the policy premiums (annual exclusion gifts) can be exempt from gift tax.
  - 3-year rule

Additional Trusts for Larger Estates

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

Limited Partnerships and Limited Liability Companies

- By transferring income-producing capital assets (i.e., rental property) into an LP or LLC, 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 share.

- Gifting fractionalized LP and LLC interests in assets can be an effective way to make maximum use of an individual's federal transfer tax applicable exclusion amount during life.

- Entities can provide a measure of asset protection.

More about Asset Protection

- Insurance
- Entities (LLC, LP)
- Irrevocable Trusts (e.g., QPRT)
- Domestic Asset Protection Trusts (for residents of states such as Nevada, Alaska, etc.)
- Offshore Asset Protection Trusts

Thank you!

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

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