

# **IT'S YOUR ESTATE**

## **WEEK 3-WILLS & TRUSTS**

**(pages 11-14 in your “Financial and Estate Literacy” workbook)**

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## IMPORTANT TAX TERMS

**GROSS ESTATE** - The grand total of everything you own on your date of death, without subtracting any debt. In probate, your probate fee will be a percentage of your gross estate. (Note: life insurance, retirement accounts – anything that has a named beneficiary – will not be part of probate. BUT for estate tax purposes, the IRS will include life insurance and retirement accounts to calculate your gross estate)

**ESTATE TAX** - This is a one-time tax on your estate when you die. The tax applies only to the portion of your estate that exceeds the Federal Estate Tax Exemption amount.

**TAXABLE ESTATE** - The portion of your estate that the IRS can tax for estate tax (“death tax”). Calculated: gross estate minus debt minus the federal estate tax Exemption amount

**COST BASIS** - Essentially, the purchase price you paid when you acquired property that has appreciated in value (your house, stock) Talk to your CPA about calculating the cost basis of your home to include major improvements and subtract allowable depreciation.

**CAPITAL GAINS** - The profit you make when you sell appreciated property. Calculated: sale price minus your cost basis

**STEPPED-UP BASIS** - If you inherit an asset from someone after they die, your cost basis in that asset is its fair market value as of the deceased person’s date of death. If you give the asset away as a gift during life, the person who receives it takes your original cost basis. Note: Putting a child on title to your house as a joint tenant = a lifetime gift.

**FEDERAL ESTATE TAX EXEMPTION** - The amount you can pass on to your family with no estate tax. Currently \$12,060,000 for an individual and \$24,120,000 for a couple. Scheduled to go down to \$5,000,000 in 2026 per person if Congress does not act.

**ANNUAL GIFT TAX EXCLUSION** - Amount you can gift each year per person with no tax consequences. You and your spouse can each gift \$16,000 per person (\$32,000 as a couple) to as many people as you like. A good way to reduce the size of your taxable estate.

**1. What's your "estate"?**

Everything you own

**2. What are you planning for?**

- A. For two events – incapacity and death
- B. To minimize Estate Taxes and Capital Gains Taxes
- C. To Avoid Probate, because it is: Expensive, Time-Consuming, and Public

**3. What does "planning" consist of?**

- A. Preparing legally enforceable documents that contain your INSTRUCTIONS about what you want to happen with your estate in the event of your incapacity and in the event of your death.
  - (1) Will (death only)
  - (2) Living Trust (death & incapacity)
  - (3) Durable Power of Attorney (incapacity only)
  - (4) Advance Health Care Directive (incapacity & handling remains)
- B. Holding TITLE to your property in a way that will:
  - (1) avoid probate
  - (2) give legal authority to people you have chosen so they can handle your estate when you're incapacitated and after you die.

**4. Why do I need a will AND a trust?**

- A. Will alone is not enough
  - (1) \$166,250 limit on a will – won't keep you out of probate
  - (2) Doesn't handle incapacity planning while you're alive
  - (3) Can't control money for children after your death
- B. Will is useful to do the following:
  - (1) Establish your intent to leave everything to your trust
  - (2) Pass tangible personal property after you die
  - (3) Name Guardians for minor children

**5. What is a "living"trust?**

- A. Legally enforceable written instructions that you create that:
  - (1) tells how your estate will be managed to take care of you if you are incapacitated
  - (2) tells how it will be managed and distributed after you die
  - (3) appoints the people who will have legal authority to carry out your instructions

- B. Is enforced by the state of California
- C. Is revocable – can be amended and revoked while you are alive
- D. As of Jan.1, 2017, new Medi-Cal Estate Recovery Rules. Anything owned in your trust when you die cannot be reached by Med-Cal to pay Medi-Cal back for any benefits you received from Med-Cal

## 6. The “players” in a revocable trust

- A. Trustor - the person who made the trust and owns the property in the trust. You are the trustor - that never changes.
- B. Trustee - the manager of the Trust - the person who has legal authority to do business with the property that is in the trust
  - (1) Original trustee - you are trustee while you are alive and capable of doing the job
  - (2) Successor trustee(s) - person or people you nominate to take over the trustee job if you are incapacitated and when you die
- C. Beneficiaries
  - (1) people who have the right to get the benefits of the property that in the trust (income, principal)
  - (2) While you are alive, you are the only beneficiaries of the trust.
  - (3) Remainder beneficiaries - The people you name who will inherit your estate when you die. Remainder beneficiaries get what's left, if anything, when you die.

## 7. Funding your Trust - TITLE! (Title = legal ownership)

- A. After you create your trust and sign it, you must CHANGE TITLE on real estate and accounts to make the trust the “owner”
  - (1) Your Trust is used as a “straw man” to be the legal owner of your property
  - (2) When you die, the owner of your property has not died. The trust still owns the property. All that is needed is for your successor trustee to become the new manager
  - (3) Same for incapacity – your successor trustee will step in to take over management duties and will manage the trust to take care of you

- B. Assets that will be owned by your trust:
  - (1) Real Property (your house, rentals)
  - (2) Investment Accounts
  - (3) Cash Accounts
  - (4) Stock
  - (5) Business interests (LLC membership, partnership interest)
  
- C. Assets that will not be owned by your revocable trust
  - (1) Retirement Accounts
  - (2) Life insurance (you can make the trust the beneficiary of a life insurance policy, but it won't be the "owner" of the policy. (But see life insurance trust, below)

## 8. **Federal Estate Tax Law**

- A. Exclusion Amount - the amount each person can leave at death with no estate tax. Estate tax will apply to anything you leave at your death over the exclusion amount
  
- B. Old Estate Tax Law before recent changes
  - (1) lower exclusion amount
  - (2) "use it or lose it" exclusion amount
  
- C. Recent Changes in Estate Tax Law
  - (1) Much larger exclusion amount – \$12,060,000 per person
  - (2) Portability - Unused exclusion of one spouse is portable to surviving spouse ( \$24,120,000 for a couple)
  - (3) Exclusion amount set to go back to \$5,000,000 per person in 2026 (\$10,000,000 for a couple)

## 9. **Different kinds of revocable trusts:**

- A. A-B Trust for married couples
  - (1) Very popular under old estate tax law before portability
  - (2) At death of 1<sup>st</sup> spouse, trust is required to be split into 2 sub-trusts: A Trust for the Surviving Spouse's half of the trust, and B Trust for the Deceased Spouse
  - (3) If you have an old A-B trust – check with an attorney to see if it still makes sense for you.

**B. Disclaimer Trust**

- (1) At first death, the whole trust stays with the surviving spouse, remains revocable
- (2) Surviving Spouse has option of disclaiming a portion of the trust and creating the A-B Trust

**10. A-B Trust - Advantages & Disadvantages:****A. Advantages**

- (1) B Trust is irrevocable - cannot be changed by surviving spouse
- (2) Can "lock" money up for children of one spouse in a blended family
- (3) Money in B Trust can never be looked at again for estate tax purposes after death of first spouse

**B. Disadvantages**

- (1) B Trust is irrevocable and is a separate taxpayer - Surviving Spouse has significant management duties
  - (a) New Tax ID Number for B Trust
  - (b) Must file income tax return for B Trust each year
  - (c) Must account to beneficiaries of the B Trust
- (2) Capital assets in B Trust get limited step-up in basis - only as of the death of the 1<sup>st</sup> spouse
  - (a) Can result in increased capital gains tax when B Trust asset is sold
  - (b) Before new estate tax law, increased capital gains tax was considered a good trade-off for avoiding estate tax.

**11. Disclaimer Trust - Advantages & Disadvantages****A. Advantages**

- (1) easier to administer for surviving spouse
- (2) get full step-up in cost basis - reduces capital gains tax

**B. Disadvantages**

- (1) Deceased Spouse loses control. Surviving spouse can change the trust
- (2) In blended family, surviving spouse could cut out children of deceased spouse
- (3) If Surviving Spouse re-marries, new spouse could influence Surviving Spouse to change trust to the detriment of deceased spouse's children.

## **12. Irrevocable Trusts**

- A. Irrevocable Life Insurance Trust ("ILIT")
  - (1) Used to reduce the size of your gross estate for estate tax purposes
  - (2) Can use annual gift exclusion to pay for premiums
  - (3) Significant Administrative duties for Trustors
  - (4) Trust must purchase the insurance policy
  - (5) If you already have a large life insurance policy and you want to put it into an ILIT, you can do that but the estate tax protection won't kick in for 3 years after the transfer
- B. Medi-Cal Qualifying Trust
  - (1) You permanently give up your ownership of your property to make you "poor enough" to qualify for Medi-Cal
  - (2) Restrictions on your ability to get money out of the trust. Easy to make a mistake. Check with Carl Lachman about his experience with this type of trust
  - (3) I don't do this kind of trust, but I can refer you to an attorney who does.