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WHAT'S NEW IN ESTATE PLANNING 2016 ANNUAL REVIEW



Estate Taxes

- \$5,450,000 Estate Tax Exemption: You can leave \$5,450,000 free of estate tax upon your death. A couple can leave a total of \$10,900,000 without estate tax. The exemption is indexed for inflation and could increase each year.
- 40% Estate Tax Rate: If your estate is more than \$5,450,000, there will be a 40% tax on the excess over \$5,450,000.
- Portability & Filing of Federal Estate Tax Return: You can transfer all or part of your \$5,450,000 estate tax exemption to your surviving spouse.
 - Your executor **must** file an estate tax return (Form 706) to make this “Deceased Spousal Unused Exemption” (DSUE) election, even if no estate tax return is required to be filed.
 - The Portability election started in 2011.
 - Your surviving spouse can use your exemption to make lifetime gifts or leave assets tax-free at death.
 - If you are a surviving spouse who plans on remarrying, considering gifting the left over exemption (DSUE) during your lifetime. You will lose your DSUE if your new spouse dies before you.

Estate Taxes, Continued

- Amend A-B Trust? A married couple with an A-B Trust needs to evaluate whether to amend their trust to make Trust B optional instead of mandatory. Trust B may no longer be necessary for estate tax planning, although it still offers many other benefits. See “Do We Need an A-B Trust?” attached.
 - Trust B Get a New Basis?: At the death of the first spouse, if a “QTIP Election” is made for Trust B **and** a “DSUE Portability Election” is made on the federal estate tax return, can Trust B get a stepped up basis on the death of the surviving spouse? Since the “QTIP Election” is necessary to “reduce federal estate tax to zero”, the IRS won’t disregard the QTIP Election under Rev. Proc. 2001-38?
- Obama Green Book Proposals: The President proposes the following laws. If Hillary or Bernie becomes President, this could be a look into the future.

PROPOSED LEGISLATION

- \$3,500,000 Federal Estate and GST Exemption without index for inflation
 - \$1,000,000 Gift Tax Exemption
 - 45% top transfer tax rate
 - Portability of the Estate Tax Exemption, but \$1M limit for gifts during survivor’s lifetime
 - 90 year limit on GST exemption
 - Eliminate Crummey powers and substitute new annual exclusion of \$50,000 to irrevocable trusts
- Estate Basis Reporting - Basis Consistency Rule (IRC §1014(f))
 - Basis Consistency: The beneficiary’s income tax basis must be consistent with the federal estate tax return values. If a discounted value is used on the federal estate tax return, the discounted value is the new income tax basis for the beneficiary.
 - Basis Reporting: New Form 8971, which identifies the value for the beneficiary must be furnished by the executor to the IRS and the beneficiaries within 30 days of filing of the federal estate tax return, identifying the value of each property. For federal estate tax returns filed after July 31, 2015, the due date is postponed to Feb. 29, 2016.

Gift Taxes

- \$14,000 per person (\$28,000 per couple) Annual Exclusion: The exclusion is unchanged for 2016. These gifts can be made each year without filing a gift tax return. These Annual Exclusion gifts do not count against your Lifetime Exemption, below.
 - ABLE Accounts (IRC 529A): Under the new “Achieving a Better Life Experience Act” (ABLE Act), a person who became disabled before age 26 can set up an ABLE account to received “non-deductible” contributions up to the gift tax annual exclusion. Similar to a 529 College fund, it grows tax free and withdrawals are tax free.
 - Tax-free distributions can be made for “qualified disability expenses” including education, housing, and transportation. There are penalties for non-qualified distributions.
 - Anyone can contribute, such as friends and family.
 - ABLE account under \$100,000 are not considered the disabled person’s resources for SSI and Medi-Cal eligibility.
 - No 5 year pre-funding of annual exclusion gifts like a 529 College account.
 - Medical and Educational Expenses: You can pay anyone’s medical care and educational expenses if you make your payment directly to the provider of services.
- \$5,450,000 Lifetime Exemption Amount: You can give up to \$5,450,000 (\$10,900,000 for a couple) during your lifetime without paying a gift tax, although a gift tax return will be due. The portion of your exemption used during your lifetime will not be available at your death. If you have made gifts in the past, consider more gifting to use your increased exemption.
- 40% Gift Tax Rate: If you give more than \$5,450,000 to your beneficiaries, there will be a 40% tax on the excess over \$5,450,000. Any amount you give to your spouse is tax free.
- Carryover Income Tax Basis: When you make a gift, you give your income tax basis (cost, plus improvements, less depreciation) to the recipient. In general, this means that your donee will continue to hold your capital gain or loss.

Generation Skipping Transfer Tax (GST)

- **Another Tax?**: In addition to the estate tax and the gift tax, there is another transfer tax called the generation-skipping transfer tax (GST Tax), which has been in existence for decades. If you make transfers to your grandchildren or great-grandchildren, you are skipping over the generation of your children. This is when there can be a GST tax in addition to an estate or gift tax.
- **\$5,450,000 GST Exemption**: You can make these generation skipping transfers up to \$5,450,000 (\$10,900,000 per couple) during your lifetime or at death without paying a GST tax.
- **GST Exemption is NOT Portable**: Unlike the estate tax exemption, the GST is not portable to your spouse. Use it or lose it. A married couple can use both their GST exemptions in an “A-B Trust”.
- **GST Trust**: A GST Trust is a trust that provides for your child during the child’s lifetime. The trust will be protected from the child’s creditors and a divorcing spouse. Upon the child’s death, there will be no estate tax since you are skipping over the generation of your child. The trust will be then be held for the benefit of your grandchildren.
- **40% GST Rate**: If you transfer more than \$5,450,000, there will be a 40% GST tax on the excess over \$5,450,000. Remember that the GST tax is in addition to the estate and gift tax. Thus, if you make a generation skipping transfer of more than \$5,450,000, there will also be a 40% tax on the excess over \$5,450,000.

Income Taxes

- **Income Tax Rate on Trusts and Estates and the 65 day Rule (IRC §663(b))**: The Federal Income Tax rate on income accumulated in an irrevocable trust or probate estate is 39.6% (top rate) on \$12,300 (2015) of income. Trust income which is distributed to a beneficiary is taxed at the beneficiary’s rate, rather than the trust rate. Under the 65-day rule, Trustees have until **March 6, 2016**, to distribute 2015 trust income to the beneficiaries so that it will be taxed at the beneficiary’s tax rate.
- **Marriage Penalty – Mortgage Interest Deduction**: Unmarried taxpayers and Registered Domestic Partners (RDOM) can deduct twice as much mortgage interest as married taxpayers. Generally, each unmarried taxpayer and RDOM can deduct interest on \$1 million in mortgages, which could be a total of \$2 million in mortgages. However, married taxpayers are limited to the interest on \$1 million in mortgages. Anyone considering marrying, including same-sex partners, needs to consider this tax penalty. Since these jumbo mortgages occur in the “blue states” (Democratic), which have such high real property values – California, New York, Massachusetts, will a Republican led congress try to reduce or eliminate the mortgage interest deduction?

Administration after Death

- Probate Avoidance - General Assignment to Trust (Ukkstad): If you die with property in your own name, but you signed a General Assignment of “all real and personal property” to your revocable trust, probate could still be avoided. A petition could be brought after death to get a court order that the property belongs your trust.
- Sale of Specific Bequest Property (Siegel): Even if your estate plan leaves specific assets to an individual, that individual cannot prevent the sale that asset, which may need to be sold to take care of you during your lifetime.
- Notification by Trustee (Williams): Upon your death, your trustee must mail a Notification by Trustee to each of your beneficiaries and all of your heirs (even if not included in your estate plan) to let them know they have up to 120-days to contest the terms of the trust. If a Notification is not sent, a contest could be brought after 120-days. Note that a beneficiary can still contest the trustee’s performance in the “administration” of the trust.

Debtors and Creditors

- Uniform Voidable Transactions Act: Replaces the Uniform Fraudulent Transfers Act. A creditor does not have to prove intent to defraud in order to void a transfer. Rather, the creditor needs to prove there was a transfer without receipt of reasonable equivalent value. This law will help creditors in the collection of assets. For example, this could help estates recover assets from someone who unduly influenced an elder.
- Homestead Exemption (CCP §704.730): You can file a “homestead” against your dwelling. In the event that the home must be sold to pay creditors, the “homestead exemption amount” still belongs to the owner. The homestead exemption amount for seniors over age 65 is \$175,000.
- Social Security Deposits Protected from Creditors (Kilker): A bank account is protected from creditors if you can prove it contains only Social Security Deposits. Direct deposits to a segregated account is advisable.
- Optional Discretionary Trust Protects Beneficiary (Sandfa): Decedent’s Trust provided for an outright distribution to a beneficiary OR a discretionary trust if the beneficiary was in Bankruptcy. The trust for the beneficiary was protected from the beneficiary’s creditors.

Elder Law

- Establishing Bank Account Using Power of Attorney (Stern): A national bank could refuse to allow the creation of an account with an Agent using a Power of Attorney without the Principal present.

Retirement Plans

- Spousal Rollover of Retirement Plan Payable to Trust (PLR 201523019) or Estate (PLR 201511036): A spouse can rollover the deceased husband's retirement plan if it is payable to her, but can she rollover the retirement plan if it is payable to her deceased husband's "trust" or "estate"? The rollover was allowed in these cases because 1) the spouse was the sole trustee of her husband's trust, 2) she allocated the retirement plan to the marital (QTIP) trust, 3) and she had an unlimited power to change the trust beneficiaries (general power of appointment).
- See Through Trust (Treas Reg 1.401.(a)(9); PLR 201503024): IRA was payable to a trust which provided for outright distribution to the children at age 30. The children were all age 30 and entitled to outright distribution. Each child was allowed to establish an "Inherited IRA".
- Bankruptcy: Includes Inherited IRA's (Clark): Mother left daughter \$450,000 IRA, and daughter created "inherited IRA account". 10 years later, daughter filed for bankruptcy.
 - Unprotected – Inherited: The inherited IRA was not protected from daughter's creditors since it was not the daughter's "retirement fund". Child must withdraw over life expectancy, could withdraw entire amount without penalty, and couldn't make retirement contributions.
 - Protected - IRA Trust: If mother left IRA payable to an "IRA Trust" for the benefit of the daughter, it would have been protected from daughter's creditors.

Litigation

- Reformation of a Will (Duke; Ca. Prob. Code §21102c): A court can reform your Will after your death using evidence of your intent. The law requires clear and convincing evidence of 1) your intent at the time the Will was written, and 2) that the Will had a "mistake of expression" at the time it was written. The Will in this case provided that the entire estate passed to charity if both husband and wife died, but the Will was silent as to the distribution if one spouse survived.
- Trustee Surcharged (Moore): Attorney who was acting as temporary trustee was surcharged for unreasonable fees and medical expenses. Client, who had dementia, told the attorney to sue his son for elder abuse. The attorney ran up expenses and defended that his client told him to do it. No defense.
- Removal of Trustee (Sterling): The owner of the Los Angeles Clippers basketball team was properly removed as trustee of his trust due to his incapacity. The successor trustee properly followed the terms of the trust for removal by obtaining two doctor's letters of incapacity. Trustee sold the team for \$2 Billion.

Parent and Child Relationship

- Presumption of Paternity – Biology is Irrelevant (Emma, Fam 7611): Even if Husband is not the biological father, he was presumed to be the child's father because he was married to wife and child was born within 300 days after the marriage. Genetic testing is irrelevant even though a blood test can identify the actual father.

Community and Separate Property

- Tracing Separate Property (Fam 2581/852): Partnership acquired in the names of both husband and wife was the separate property of husband. Husband was able to “trace” his separate property owned prior to marriage. The joint title community property presumption was overcome by tracing. (Brandes) Partnership in name of husband was modified to be in names of both husband and wife. Husband had a right to reimbursement of his separate property contribution. No automatic “transmutation.” (Lafkas)
- Property Acquired Before Separation is Community Property (Davis; Fam Law 760/771a): Couple were separated but continued to live in the same house, a common occurrence during the recession when neither spouse could afford to move out. This case held that until the couple is physically separated, their earnings are community property.

Same-Sex Marriage

- Same Sex Marriage is Legal in all 50 States (Obergefell; US Supreme Court): The 14th Amendment to the Constitution requires a state to 1) license a marriage between two people of the same sex, and 2) to recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed out-of-state. In order to secure a same sex marriage, marry in the state of your residence (if you married out of state). If not yet married, get married now.
- What Happens to California Registered Domestic Partners (RDOM)?: There is no automatic conversion of a RDOM to “marriage”. RDOM is still treated differently for federal purposes than a marriage. RDOM's get two mortgage interest deductions, Social Security based on previous marriage continues, lower income tax rate since can file individually and split income.

Property Tax

- Loophole in Joint Tenancy Rules (State Board of Equalization): If two people hold title to California real estate as “tenants-in-common”, there can be a reassessment of their property tax value at the first death. However, if they change title to “joint tenancy”, then there will no reassessment at the first death since property is being transferred to an “original transferor” under the joint tenancy rules. For example, this could be a benefit to siblings who want to leave real property to each other.

Transfer on Death Deed

- Transfer on Death Deeds (TOD) (PC 5600-5696): There is a new “revocable transfer on death deed” (TOD deed) which avoids probate without the use of a revocable trust.

The TOD deed can be used for the following real property:

- Improved real property with up to 4 residential dwellings (not raw land)
- Condominium
- Agricultural real estate up to 40 acres improved with a single family residence.

The TOD deed must:

- Name a beneficiary or beneficiaries
- Be recorded within 60 days of signing/notarizing.

On the death of the owner, the beneficiary must:

- File a change of ownership report with the county regarding reassessment, and
- Notify Medi-Cal if benefits were paid to allow Medi-Cal to pursue a right of reimbursement.
- The beneficiary is liable for the transferor’s debts and the probate estate can pursue the beneficiary for payment of debts.

This law is a 5 year trial from 2016 to 2021. Deed is effective if signed before 1/1/2021.

Health Care

- POLST Registry –Physician’s Orders for Life Sustaining Treatment (PC 4348): There is a new California POLST eRegistry pilot program authorized until 2020. Physicians will submit a copy of your POLST to the registry unless you or your agent chooses not to participate. The agency is required to give your POLST to “authorized users.” You can download the California POLST form at <http://capolst.org>. The POLST can now be signed by your physician, physician’s assistant or nurse practitioner.
- End of Life Option Act (Health & Safety 443): Until 1/1/2026, an adult with a terminal disease can request medication to end his life.

The law prohibits:

- Contract, will or other agreement being conditioned on making or rescinding a request for medication to end life;
- Sale of insurance, health care insurance, and annuities conditioned on a request for medication to end life;
- Insurance companies from providing information about the request unless requested by patient, physician or patient’s agent.

It is a felony to:

- To forge a request or conceal or destroy a rescission of request with intent to cause death;
- To unduly influence another to make the request or destroy the rescission of the request.
- Penal Code 401 (since 1873): Deliberately aid, advise, or encourage another to commit suicide

Opponents have already filed to challenge the law by referendum in 2016.

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DO WE NEED AN “A-B TRUST”?

This checklist is created to help you see the considerations in determining whether the A-B Trust structure is best for your situation. If you believe the advantages of Trust B outweigh the disadvantages, then an “A-B Trust” better suits your goals.

Advantages of Trust B

Disadvantages of Trust B

Control Distribution	Unable to change Trust B Distribution (unless special power of appointment)
Creditor Protection	Lose new income tax basis upon 2nd death
Exclude Appreciation from Survivor’s Estate	Decedent’s federal estate tax Exemption is portable to Surviving Spouse
Protect Decedent’s California real property Parent-Child Exclusion	Unable to Borrow against Trust B assets
Medi-Cal Qualification without exhausting Trust B assets	Annual Accounting and Income Tax Return
Protection Decedent’s Generation Skipping Transfer tax exemption	Extra administration fees
Reasonable Support of Surviving Spouse	
Surviving Spouse Moves to State that has State Estate Tax	
Surviving Spouse Remarries: No loss of predeceased spouse’s exemption.	

Advantages of Trust B Explanation

Control Distribution	The distribution plan must be carried out after the surviving spouse dies. Trust B becomes irrevocable upon the first spouse to die.
Creditor Protection	Creditors are unable to attack the assets in Trust B.
Exclude Appreciation	Appreciation in Trust B assets are excluded from taxes.
Protect Decedent's California real property Parent-Child Exclusion	Trust B preserves the Decedent's right to leave a residence plus \$1 million of assessed value of real property to the children without reassessment of property tax.
Medi-Cal Qualification without exhausting Trust B assets	Trust B assets are not counted toward Medi-Cal eligibility.
Protect Decedent's Generation Skipping Transfer tax Exemption	Trust B preserves the decedent's GST exemption, since the decedent's GST exemption is not "portable" to the surviving spouse. In 2016, the GST exemption is \$5.45 million.
Reasonable Support of Surviving Spouse	Trust B typically allows for the support of the Surviving Spouse.
Surviving Spouse Moves to State that has State Estate Tax	If the Surviving Spouse moves to a state with a State Estate Tax, Trust B is not subject to State Estate Tax upon death.
Surviving Spouse Remarries: No loss of predeceased spouse's exemption	If the Surviving Spouse remarries and survives the new second spouse, the Surviving Spouse can get the second spouse's unused exemption but will lose the unused portion of the predeceased spouse's exemption. The Surviving Spouse, however, could make gifts using the predeceased spouse's exemption before the second spouse dies.

Disadvantages of Trust B Explanation

Unable to change Trust B Distribution	Although surviving spouse may have access to Trust B assets, they cannot alter the distribution of those assets after their death.
May lose new income tax basis upon 2nd death	Generally, assets in Trust B do not get a basis step-up upon the second spouse's death.
Unable to Borrow against Trust B assets	The surviving spouse cannot use Trust B assets as collateral. (ex. unable to use Trust B assets to refinance)
Decedent's federal estate tax exemption is portable to Surviving Spouse	In 2016, the \$5.45 million exclusion, discussed above, can be achieved without the Trust B structure using "Portability".
Annual Accounting and Income Tax Return	Beneficiaries of Trust B can request an accounting of the Trust. The Trustee must prepare an income tax return for Trust B.
Extra administration fees	Along with the annual accounting and income tax returns, the initial division of assets upon the first spouse's death will cause extra administration fees.

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