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WHAT'S NEW IN ESTATE PLANNING 2017 ANNUAL REVIEW



Estate Taxes

- **\$5,490,000 Estate Tax Exemption**: You can leave \$5,490,000 free of estate tax upon your death. A couple can leave a total of **\$10,980,000** without estate tax. The exemption is indexed for inflation and could increase each year.
- **40% Estate Tax Rate**: If your estate is more than \$5,490,000, there will be a 40% tax on the excess over \$5,490,000.

- **Discussion**:

Why do I still need an Estate Plan?

Having an estate plan is still important to avoid Probate (approximately 1 year and 5% of estate in attorney and executor fees), avoid a court Conservatorship by planning to deal with incapacity, and distribution planning.

- **Portability & Filing of Federal Estate Tax Return**: You can transfer all or part of your \$5,490,000 estate tax exemption to your surviving spouse. The portability election started in 2011.
 - **File Form 706**: The 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.

Estate Taxes

- **Late Portability Election (IRC 2010; Chief Counsel Advice 101650017)**: If estate was less than the Exemption (e.g. \$5 million), then a late portability election can be requested in a Private Letter Ruling. If the estate was more than the Exemption, no relief to make a late portability election.
- **Discussion**:

1. Why Should I Care About a Late Portability Election?

Did your spouse die after 2010 and no federal estate tax return was filed because the estate was under the exemption (@\$5 million)? Are you a surviving spouse with a total estate of about \$5.49 million or more? You can still file an estate tax return if it has been less than 9 months since the death. If it has been more than 9 month, you can make a late portability election. The goal is to reduce the estate tax bill upon your death.

2. Can You Give Me an Example?

When my husband died in 2011, we had assets of about \$4 million. We were slowly coming out of the recession when he died and I didn't file an estate tax return because I didn't have to since the estate was less than the exemption.

I never dreamed that our home value would increase by 50% and our stock value would go up 80%, like it has. Now my assets are worth \$6.5 million.

My kids will have to pay about \$400,000 in federal estate taxes 9 months after my death. I wish I had filed an estate tax return to elect portability of my husband's unused exemption amount. I would have received his \$5 million exemption, plus I would have my own \$5.49 million exemption. My kids could receive over \$10 million tax free instead of paying a \$400,000 tax. What can I do? Obtain a Private Letter Ruling for relief.

3. What is a Private Letter Ruling (PLR)?

The taxpayer sends the IRS a request for a letter ruling along with the applicable user fee. The IRS issues a written statement to the taxpayer that interprets and applies the tax laws to the taxpayer's set of facts. The basic user fee is \$28,300 per request.

Estate Taxes

- **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 such as controlling the distribution to your heirs.
 - **Discussion:**

1. **Should I Amend my Trust?**

Have you and your spouse reviewed your estate plan with an attorney since 2011? Is the total estate less than \$10.98 million and unlikely to exceed this amount in the future? Consider amending your “A-B Trust” to make the creation of Trust B optional rather than mandatory after the first death. This is called a “Disclaimer A-B Trust”. The surviving spouse will have 9 months after the death to decide whether to create Trust B.

2. **Can You Give Me an Example?**

Hal and Wanda have been married for 45 years. They have two children, Charles and Charlotte. Hal and Wanda want to make life as simple as possible for the survivor. They are confident that the survivor will look out for the children. Their combined assets are \$3 million. Hal and Wanda had an A-B trust prepared in 2002, for estate tax purposes. Now in 2017, an A-B Trust is not necessary in their case for estate tax purposes, so they could simplify their estate plan.

3. **Why Would We Want to Keep Trust B?**

Herbert and Wilma have a blended family. Herbert has two children of a prior marriage, and Wilma has four children of her own. Herbert and Wilma want to take care of each other, but each of them wants to provide for their own children when they are both gone. Neither spouse wants the other spouse to change the distribution plan. This is a good reason to continue to have an “A-B Trust”.

4. **Is it Too Late to Amend the Trust if My Spouse has Already Died?**

I am the surviving spouse and there is a Trust B for my benefit. I am tired of the recording keeping and extra tax return. Can I terminate Trust B?

- Court Order of Modification or Termination: Consent of beneficiaries; persuade Court that Trust B serves no “material purpose”; spendthrift clause obstacle?
- Discretionary Distributions to Spouse
- Termination if Nominal Value

Estate Taxes

- **QTIP Election & Portability Election (Rev. Proc. 2016-49)**: It is possible to make both a QTIP Election (defer tax until death of survivor) and Portability Election (transfer Exemption to spouse) on the estate tax return (Form 706). This technique can be used to get a new income tax basis on Trust B assets at the death of the surviving spouse.

- **Discussion:**

1. **Who Should be Concerned?**

My spouse died after 2010, and we had an A-B Trust. I didn't file an estate tax return when he died because it wasn't required for his estate of less than \$5 million. Our assets have really appreciated since the recession.

2. **What Happened to Stepped-Up Basis?**

I understand that my assets in Trust A will get a new income tax basis when I die; my kids will be able to sell those assets without capital gain. I am not happy that Trust B assets will not get a new income tax basis at my death since I don't own those assets. The kids will have a lot of capital gain when they sell the Trust B assets.

3. **Can I Get the Second Income Tax Basis Step-Up?**

You could request a Private Letter Ruling to make a late portability election and make the "QTIP Election" on Trust B. In order to have a "QTIP-able Trust B", Trust B must provide that all income is payable to the surviving spouse for life and distributions of principal, if any, may only be paid to the surviving spouse. The QTIP election causes Trust B to be included in the surviving spouse's estate to get the stepped-up income tax basis. The portability election results in the survivor having two exemptions.

Trump Tax Act?

- **DonaldJTrump.com:**

“The Trump Tax Plan Ends The Unfair Death Tax: The death tax punishes families for achieving the American dream. Therefore, the Trump plan eliminates the death tax.”

- **Will the Estate and Gift Tax be Repealed?**

Total permanent repeal would probably require 60 votes in the Senate otherwise the legislation could be obstructed by a filibuster. There are now 52 Republican Senators.

Temporary repeal with a 10 year sunset provision could be passed with a simple majority, which would be 51 votes.

- **Will the Estate and Gift Tax be replaced with an Income Tax?**

There could be a requirement to report all lifetime capital gains over \$10 million at death. Basis step-up for assets over \$10 million could be disallowed and the heirs would report capital gain on their sale of the assets.

- **Will there be no change?**

Since elimination of Estate and Gift taxes could be perceived as benefitting the rich, and since the revenue from this tax is less than 1% of the Federal revenue, could the Republicans give up on repeal in exchange for some other legislation?

Gift Taxes

- **\$14,000 per person (\$28,000 per couple) Annual Exclusion:** The exclusion is unchanged for 2017. 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.
 - **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.
- **\$5,490,000 Lifetime Exemption Amount:** You can give up to \$5,490,000 (\$10,980,000 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 \$5,490,000 to your beneficiaries, there will be a 40% tax on the excess over \$5,490,000. 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.
- **\$5,490,000 GST Exemption**: You can make these generation skipping transfers up to \$5,490,000 (\$10,980,000 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 \$5,490,000, there will be a 40% GST tax on the excess over \$5,490,000. 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 \$5,490,000, there will also be a 40% tax on the excess over \$5,490,000.

Administration after Death

- **Revised Uniform Fiduciary Access to Digital Assets Act (PC 870)**: Authorizes your personal representative/trustee/power of attorney agent to access your digital assets/communications. Account holder can use an online tool to direct the “custodian” (e.g. Google) to disclose/terminate an account.

- **Discussion: What Can You Do Now?**

1. **Online Sites, Usernames, and Passwords**

Keep a list of usernames and passwords for access. Do you want your fiduciary to login to your accounts? Do you want your fiduciary to see all emails and communications?

2. **Provider/Custodian “Tool”**

Use the provider’s “tool” (Ex. Google’s Inactive Account Manager) to authorize access to your account upon the occurrence of an event, such as no activity after 6 months. In Google’s “tool”, you are able to limit access to specific data (Ex. Emails, Pictures, Videos, and Blogs).

3. **Update Estate Plan: Authorize Access**

Consider updating your Will, Trust, and/or Power of Attorney to authorize your Fiduciary to have access to all of your online accounts. This will include all emails, data, and communications. This is subject to the discretion of the provider.

Sample Language:

“The Agent is authorized to do the following:

(1) Access, use, and control the Principal's digital devices, including desktops, laptops, tablets, peripherals, storage devices, mobile telephones, smartphones, and any similar digital device that serves to access, modify, delete, control, or transfer the Principal's digital accounts or assets;

(2) Access, modify, delete, control, and transfer the Principal's digital accounts, including bank accounts, e-mail accounts, blogs, software licenses, social network accounts, social media accounts, file-sharing and storage accounts, financial management accounts, domain registration accounts, domain name service accounts, web hosting accounts, tax preparation service accounts, online store accounts, and affiliated programs; and

Administration after Death

(3) Access, modify, delete, control, and transfer the Principal's digital assets, including e-mails, blog posts, documents, images, and audio, video, and other digital files, whether stored on a digital device or in a digital account.”

- **Business Partner not Competent to be Executor (PC 8402):** If you named your business partner as the executor in your Will, they can be automatically disqualified, if someone objects. Potential conflicts of interest. Your business partner may have competing interests in administering your estate.

- **Discussion of Fiduciary Conflicts of Interest:**

1. **Conflict: Business Partner as Fiduciary**

Example: Paul and Phil are Partners in a Widget business. They have a buy-sell agreement in the business where the survivor has the right to buy out his partner's interest. The price is determined by the buyer and the seller. Paul names Phil as his Executor. Paul dies. Phil is now negotiating the price of the business with himself. Phil wants to buy out Paul's interest at the lowest price, but he has a duty to seek the highest price for the estate.

2. **Conflict: Trustee as Beneficiary**

Example: Mom names Daughter as her successor Trustee. The Trust specifies that Daughter is to receive the House and then split the remaining assets with her siblings. During Mom's lifetime, she becomes incapacitated and Daughter takes over as Trustee. Mom starts to run out of money, but Daughter doesn't want to sell the house because then she would have to split the sales proceeds when Mom dies, instead of receiving the House.

3. **Solution to Conflicts of Interests:** Consider naming an independent Trustee who is not related to the beneficiaries. Consider naming a corporate Trustee or licensed private fiduciary who is bonded and insured.

Administration after Death

- **Notice of Proposed Action for Trust Preliminary/Final Distributions (PC 16501):**
Trustee can give 45-day “Notice of Proposed Action” (NOPA) of planned distribution to beneficiaries. If there is no objection, Trustee is protected from a future beneficiary complaint without a Probate Court Order.
- **Discussion:**

1. What is a “Notice of Proposed Action” (NOPA)?

This is a procedure that permits a trustee to notify the beneficiaries of a trust of a proposed course of action and obtain their prior consent, either directly by a beneficiary’s written consent or implicitly as a result of a beneficiary’s failure to timely object.

The “Notice of Proposed Action” (NOPA) procedure is intended to promote efficient administration of trusts, encourage open communication between trustees and beneficiaries, and to provide trustees with a mechanism for obtaining the beneficiaries’ consent (directly or by implication) prior to undertaking a course of action. Utilization of the procedure allows a trustee to confidently undertake a course of action without having to incur the expense and possible delay associated with a court hearing on the matter.

2. Example of the use of a Notice of Proposed Action (NOPA):

Upon the death of the parents, the Trust provides for an equal distribution among the three children. Trust consists of \$1 million of Stock, \$1 million House, and \$1 million in Cash.

The trustee could distribute the Stock to one child, the House to another, and the Cash to the third child. What if the following year the House doubles in value and the Stock decreases in value by half? Could the trustee be liable?

If the trustee issued a NOPA prior to distribution and received no objections, the children cannot complain about the distribution in the future.

Administration after Death

- **No Trust Accounting for Period before Death (Babbitt, PC 16060)**: Second wife did not have to account to husband's child for period before husband died when trust was revocable. There were no allegations of fraud or incapacity of husband. But in Geraldin, after death, remainder beneficiaries had right to demand accounting during lifetime. Babbitt limits remainder beneficiary rights.

- **Discussion:**

1. **What is a Trust Accounting?**

A Trust Accounting is a record of the finances within the Trust.

2. **What is the format?**

A Trust accounting consists of separate statements of receipts and disbursements, assets and liabilities, the trustee's compensation, and the agents hired by the trustee, their relationship to the trustee, and their compensation. The Probate Code provides us with a specific format for Trust Accountings.

3. **To Whom Must You Provide a Trust Accounting?**

Generally, a trustee has to provide an accounting record to each current beneficiary who is to receive income or principal.

4. **Example of a typical problems with Trust Accountings:**

If Husband and Wife have an "A-B Trust", which means that when the first spouse passes away that the trust is divided into a revocable trust (Trust A) and an irrevocable trust (Trust B).

The surviving spouse is entitled to income and principal distributions for the rest of her life from both trusts. The children don't receive any trust distributions until both spouses pass away.

Since Trust B becomes irrevocable on the death of the first spouse, the law requires that the trustee must provide an annual accounting of Trust B to the current beneficiary, who is the surviving spouse. However, the children, as remainder beneficiaries have the right to demand an annual accounting of Trust B.

This can cause conflict among the surviving spouse and the children of a prior marriage who are set to inherit Trust B when the step-parent dies.

Administration after Death

- **Trust Accounting for Commercial Rental Property (Gray, PC 16373):**

An irrevocable trust was established with commercial rental property to provide income for a friend. Upon the friend's death, the property would go to charity. The friend was also named a trustee.

This non-professional trustee filed successive poorly drafted trust accountings and failed to correctly allocate expenses for repairs between income and principal. The non-professional trustee was held liable for the charity's attorney fees in demanding the trustee comply with his duty to properly account.

- **Discussion**

- 1. Professional Trustees**

Consideration should be given to naming a professional trustee who understands the principals of trust accountings.

- 2. Conflicts of Interest**

Proper accountings prevent litigation particularly when there are conflicts between income and remainder beneficiaries, or conflicts among a child acting as trustee and beneficiary.

Administration after Death

- **Trust Contest Must be Filed within 120 Days of Notification by Trustee (Williams, PC 16061.8)**: During the Father's lifetime, he changed trust beneficiary from Son to another person. After Father's death, Notification by Trustee was sent to Son. Son contested the trust 4 years after his father's death. This was too late to contest the terms of the trust because Notification was sent and the 120-day period had elapsed.

- **Discussion:**

1. **What is a Trustee Notification?**

When a Trust becomes irrevocable, such as upon the death of the creator, the Trustee has a duty to notify all named beneficiaries and heirs-at-law that they have a right to see a copy of the Trust and have only 120-days to contest the "terms of the trust".

2. **Terms of the Trust vs. Administration of the Trust**

This right to contest the "terms of the trust" relate to the distribution plan as found in the trust. For instance, if the son contested that the trust should go to him and not the other person. It is important to understand that the notification has nothing to do with the administration of the trust by the trustee, such as, trustee breach of fiduciary duty.

3. **What is the Statute of Limitations without the Notification?**

If the Trustee does not send the Notification, the period to contest the trust is longer, depending on the basis of the contest:

1. 4 years to contest for lack of capacity (CCP 337)
2. 3 years for fraud/mistake personal property (CCP 338d)
3. 5 years for fraud/mistake real property (CCP318)
4. 1 year for promise to leave property

Administration after Death

- **New Judicial Council Forms for Probate (DE-111, DE-130)**: The new Probate Forms include additional information that is to be provided to the Probate Court, such as: disclosure of citizenship, the ability to nominate a successor Executor, disclosure of a lost/destroyed Will, characterization of property as community/quasi-community or separate property.

- **Discussion:**

1. **Lost or Destroyed Will:**

If your estate has to go through Probate, there are additional procedures your Executor has to follow if the Executor cannot find the “originally signed” (wet signature) Will.

2. **Presumption that Will was Revoked:**

If the original Will cannot be found, your Executor must overcome the presumption that you intentionally revoked your Will. In a contested manner, an omitted heir could argue that the Will cannot be found because you intentionally revoked it, whereby the omitted heir could potentially benefit from your estate.

Debtors and Creditors

- **Payment of Child/Spousal Support from Irrevocable Trust (Ferguson, PC 15305):**

The Beneficiary of an irrevocable trust owed child and spousal support. Despite the trust “shut down clause” (aka Spendthrift Provision) that would stop the trustee from making discretionary payments to the beneficiary, the Court had discretion to order the payment of child/spousal support from the irrevocable trust because public policy encourages payments of child/spousal support.

- **Discussion**

1. **How Can I Protect My Beneficiary?**

If you are concerned that a beneficiary may have creditor problems or could be involved in a divorce, you should consider whether their share should be held in a trust for their benefit rather than distributed to them outright.

2. **Protection from General Creditors**

Although it will not protect the beneficiary from child/spousal support claims, the trust is protected against their general creditors and would not be treated as community property of the beneficiary’s marriage.

- **Special Needs Trust Fairness Act of 2016 (Pub L 114-255):**

A competent disabled person can create a First Party Special Needs Trust (SNT) with his own assets, including inherited assets, in order to qualify for public needs-based benefits. The disabled person cannot be the trustee. The trust must provide for reimbursement of Medi-Cal after death.

- **Discussion**

1. **Eligibility for Public “Need-Based Benefits”**

If your beneficiary receives or potentially could receive public benefits, you should consider leaving their share to a “Third Party Special Needs Trust”. This allows the beneficiary to continue to receive public benefits, while still having the inherited funds available to provide for their supplemental needs.

2. **No Medi-Cal Reimbursement**

With a “Third Party Special Needs Trust” there is no Medi-Cal repayment requirement when the beneficiary dies.

Elder Law

- **Elimination of Medi-Cal Estate Recovery from Non-Probate Transfers (Welf & IC 14009.5):**

For a death on or after Jan. 1, 2017, the State cannot make a claim against “non-Probate assets” for the amount of Medi-Cal benefits paid to you during your lifetime. Non-Probate assets are assets transferred via living trust, joint tenancy, and beneficiary designation.

Only assets that pass through Probate are subject to Medi-Cal repayment.

Retirement Plans

- **Child’s Life Expectancy Used for RMD –IRA Payable to a Trust (IRC 401K; LR 201633025):** A Child’s life expectancy can be used to determine required minimum distributions (RMD’s) of an IRA payable to a Trust, even though siblings and charitable organizations were named as contingent beneficiaries.

- **Discussion**

- 1. Designated Beneficiary Can Establish “Inherited IRA Account”**

An IRA payable to a “designated beneficiary” can be withdrawn over the life expectancy of the beneficiary by setting up an “Inherited IRA” account. This is commonly known as the “Stretch IRA”.

- 2. What if the Trust is the Beneficiary?**

If the beneficiary is a person, it is clear this “Stretch IRA” strategy works. However, if the beneficiary is a trust, the trust must meet certain guidelines in order for the stretch IRA strategy to work. Otherwise, the IRA must be withdrawn within five years.

Wills & Trusts

- **Allocation of Taxes and Shares (Marie Callendar, PC 16335A):**

The Will provided for a bequest of real estate to the daughter, with the residue to be divided equally in thirds between the spouse, son and daughter. There was no estate tax on the share passing to the spouse; but there was estate tax on the amount passing to the children.

Do each of the children still share in one-third of the residue (royalties continue to be received)? Or are the shares for the children permanently reduced because of the tax payment? In this case, the children continued to have one-third shares.

- **Discussion:**

1. **Whose Share Pays the Expenses?**

This case illustrates the importance of thorough contemplation of issues such as distribution planning and allocation of taxes and expenses. After a death, there are many expenses during the administration: trustee fees, attorney fees, accountant fees. Whose share should be liable for those expenses?

2. **Can you Give me Some Examples?**

If a house is going to a child, does the child have to pay for the expenses of maintaining the house during the period of administration, such as property taxes, insurance, maintenance?

If you have valuable personal effects, does the trust or the beneficiary pay for the shipping expenses?

Wills & Trusts

▪ **Which Trust Owns the Real Estate? (Carne, PC 15200):**

A person transferred his home to a 1985 revocable trust. In 2009, he created a 2009 irrevocable trust and listed the same home on Exhibit A of the new trust without changing title on the Deed.

Which trust owns the real estate? In this case the creation of the irrevocable trust and listing of the home as an asset of the irrevocable trust by the Trustor/trustee of the revocable trust was sufficient to transfer the property to the new trust.

○ **Discussion**

1. Title to Assets

This illustrates the importance of proper titling of your assets and trust funding. This is particularly important with real estate because record title controls.

By properly titling your assets, you avoid Probate and minimize the expenses of administration of your estate.

2. Beneficiary Designations

As a reminder, beneficiary designations on your retirement plans and life insurance take precedence over your Will and Trust.

3. Administration after a death

Depending on how the real estate was titled upon death will determine the proper procedure for clearing title.

- Joint Tenancy with Right of Survivorship
- Community Property with Right of Survivorship
- Trust
- Revocable Transfer on Death Deed
- Individually
 - Is the property less than \$50,000? Affidavit of Real Property of Small Value
 - Is the property less than \$150,000? Petition to Determine Succession to Real Property
 - Does the property pass to a spouse? Spousal Property Petition
 - Was the property inadvertently left out of Trust? Heggstad Petition
 - If none of the above apply, Probate.

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