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ESTATE PLANNING BASICS

1.0. What is an Estate Plan?

Your estate is everything that you own. Your estate plan consists of the tools set in place to distribute or manage your property in the event of your incapacity or death, marriage, or divorce. These tools include a will, durable power of attorney for finance, advance health care directive, trusts, and marital property agreement.

2.0. What is Probate?

Probate is a court-supervised procedure for validating a will (if there is one), paying debts, and distributing the property of a deceased person. The procedure lasts about one year. A total of about six percent (6%) of your estate is paid to your attorney and executor for their services. The statutory Probate fees and Commissions are as follows:

Statutory Probate Fees and Commissions

Calculate the amount according to the chart below and then multiply by two (2), since this amount will be paid once to the attorney and again to the Executor.

This Chart gives an example of the fees paid depending on the **gross** value of the estate.
The calculation is made as follows:

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

Size of Estate	Attorney Fee	Executor Fee	Total Fee
$200,000	$7,000	$7,000	$14,000
$300,000	$9,000	$9,000	$18,000
$400,000	$11,000	$11,000	$22,000
$500,000	$13,000	$13,000	$26,000
$600,000	$15,000	$15,000	$30,000
$700,000	$17,000	$17,000	$34,000
$800,000	$19,000	$19,000	$38,000
$900,000	$21,000	$21,000	$42,000
$1,000,000	$23,000	$23,000	$46,000

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2.1. How Can I Avoid Probate?

You can plan for your estate to pass directly to your beneficiaries without probate. Using such a plan, your heirs can promptly transfer the assets using only a death certificate. There are five methods which avoid probate, discussed below. Simply having a will does not avoid probate.

2.2. Small Estate

An estate under $166,250 in value does not pass through probate. Rather, the heirs sign a declaration of small estate which they can deliver with a death certificate to a bank or broker. The institution can then transfer the assets to the heirs.

2.3. Assets Passing to a Spouse

Assets passing to a spouse do not go through a full probate. There is a short court proceeding to "set-aside" the assets to the spouse.

2.4. Named Beneficiary

Property that passes to a designated beneficiary will pass directly to that person, without probate. Be sure to name a beneficiary of your life insurance, annuities, IRA and pensions. Do not name your "estate" as the beneficiary, since this will result in the probate of the asset. Name actual people, such as your spouse or each of your children.

2.5. Joint Tenancy

If you hold an asset as joint tenants with rights of survivorship, then at your death, this property will transfer automatically to your surviving joint tenants. If you own a bank account with other owners, such as your children, then this is a joint account which will pass without probate.

It can be dangerous to add your children as joint tenants to your investments. A joint tenant can have total access to bank accounts. Also, the child's signature will be necessary to transfer stock or real estate. A child's creditor can try to attach your investment if your child's name is on it. If a child divorces, his former spouse may claim your assets are community property of your child's marriage.

2.6. Trust

Property that is held in a trust does not pass through probate. Trusts are discussed in detail below. Trusts are generally prepared by an attorney; however, there is a trust that you can create by yourself, jokingly called a "poor man's trust". You can establish this trust, also called a "totten trust", by naming a beneficiary of any bank or savings and loan account. The bank will change its records to show that the account is "in trust for (ITF)" the beneficiary. The account will pay directly to that heir at your death.

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3.0. What is a Trust?

A trust is an arrangement involving three parties. You, the "Trustor", transfer property to a "trustee" who will hold or manage the property for your "beneficiary".

3.1. Revocable Trusts

You can set up a revocable trust in which you remain in control of the funds and can even be the trustee. You hold title to your property in your name, as trustee. You can end (revoke) this kind of trust whenever you wish. Revocable Trusts are also called Living Trusts or Inter Vivos Trusts. These trusts can be set up to serve a variety of purposes.

3.1.1 Avoid Probate

The assets which are held in your trust will pass directly to your heirs at your death, without the one-year delay of a probate proceeding and without payment of about six percent (6%) of your estate to the attorney and executor. The Trustee will only need a death certificate to transfer the assets. A $400,000 estate can save $22,000 in fees by avoiding probate.

3.1.2. Management During Incapacity

In case you become ill or incapacitated, your trustee can manage your financial affairs. A living trust can be used instead of a durable power of attorney to take care of your finances in case of your incapacitation. If you do not have a living trust or durable power of attorney, then a conservator would have to be appointed by the court. In a conservatorship, the conservator and attorney are paid about two percent (2%) of your estate each year and report to the court, annually.

3.2. Irrevocable Trusts for Tax Planning

Irrevocable trusts can be used to minimize the federal estate tax which may be owing nine months after your death. If your estate is under the "applicable exclusion amount", then there will be no estate tax. However, if your estate is over the exclusion, then 40% of the amount over the exclusion will go to the IRS in taxes. The applicable exclusion amounts under current law are as follows:

Year of Death	Tax Free: Exclusion Amount	Rate of Tax
2016	$5,450,000	40%
2017	$5,490,000	40%
2018	$11,180,000	40%
2019	$11,400,000	40%
2020	$11,580,000	40%

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3.2.1. A-B Trusts for Married Couples

If you leave your property to your spouse, then at your death there will be no estate tax. Husbands and wives can transfer an unlimited amount to each other tax free.

If both you and your spouse die, your surviving spouse can leave $23,160,000 estate tax free without complex estate planning. The reason is that your $11,580,000 exclusion amount is “portable”, which means that your surviving spouse can use any unused portion of your exclusion amount in addition to the survivor’s own $11,580,000 exclusion amount. In order to get this benefit, an estate tax return must be filed on the first death in order to elect “portability” of your exclusion amount.

Long term estate planning needs to take into account these changing tax laws. Using an A-B Trust will allow two (2) exclusion amounts to pass tax free to the heirs regardless of the year of death.

Upon your death, half of the estate (up to the exclusion) goes into a "bypass" trust (Trust B) to take care of your spouse for his or her lifetime. Your spouse can be the trustee, receive all of the income, and have the use of principal for reasonable support. However, upon the death of the survivor, the balance of Trust B will pass to your heirs free of death taxes since Trust B does not belong to the surviving spouse.

Upon your death, your spouse puts the other half of the trust in Trust A. Your spouse can be the trustee and has total control over this trust, as well as the right to revoke the trust. On the survivor's death, another exclusion amount can pass tax free to the heirs.

Using an A-B Trust, two exclusion amounts can pass tax free to the heirs, which can save the heirs substantial estate taxes. Furthermore, you can be assured that Trust B will pass to your heirs even if the surviving spouse remarries. Also, Trust B has creditor protection and will not be counted as a resource of your spouse if he or she needs government assistance for long-term care.

3.2.1.2 Amend AB Trust to Disclaimer Trust

Beginning in 2010, the deceased spouse’s estate exemption ($11,580,000 in 2020) can be transferred directly to the surviving spouse without the need for a Trust B. Should you amend your trust to eliminate a mandatory Trust B? Should you amend your trust to give the surviving spouse the option to create Trust B (called a “Disclaimer Trust) after your death?

If you have an AB Trust created before 2010, you need to review it with your attorney. Although simplifying the trust will reduce record keeping after the first death, you need to consider the following advantages and disadvantages of an AB Trust.

The advantages of having a Trust B include control over the ultimate distribution plan, protection from the survivor’s creditors or a divorcing spouse, Medi-Cal qualification, additional property tax exclusions from reassessment, protection of future appreciation from estate tax in the survivor’s estate, additional generation-skipping tax exemption, and possible discount valuation.

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The disadvantages of have a Trust B include the division of assets at the first death, need for a new federal ID number, possible loss of second stepped-up income tax basis on the survivor's death, annual accounting, loss of use of assets as collateral for a loan.

3.2.2. IRA Inheritance Trust

Establishing an IRA Inheritance Trust ensures the stretch-out of your IRA along with protecting your beneficiary's from: their own or their spouse's spending habits, a divorcing spouse, creditor's, lawsuits, bankruptcy, along with other benefits.

3.2.3. Irrevocable Trusts for Children and Grandchildren

You can create an irrevocable trust to hold gifts from you for your children and grandchildren, sometimes called a "Crummey Trust". You can be the trustee who controls the money or property in the trust for the beneficiaries. Your trust can provide that money goes to a child or grandchild for a specific purpose, for instance, higher education. You can designate that the trust ends when a beneficiary has reached a certain age, for example, age thirty (30).

Sometimes an irrevocable trust owns life insurance on your life. This is called a "life insurance trust". The life insurance will not be taxed in your estate when you die since you don't own the policy.

The assets in the trust will not come back to you. You cannot change the distribution provisions of the trust since it is "irrevocable". Thus, these assets are outside of your estate which will minimize death taxes on your estate.

3.2.4. Generation-Skipping Trusts

An irrevocable trust that continues for the entire lifetime of your child is called a "generation-skipping trust". One of the great advantages of this trust is that it will not be taxed when your child dies, up to a certain limit. Consider this type of trust if your child has a substantial estate of his or her own.

3.2.4.1 The Problem: Taxes

If you leave a large amount to a child outright, then this sum can be subject to almost a 40% Federal Estate Tax when the child dies.

Solution

Instead of leaving the amount outright to the child, you could provide that the sum remains in a "Generation-Skipping Trust" during the child's lifetime. The federal government allows an individual to leave a certain amount in a generation-skipping trust, and that amount will not be taxed when the child dies. Even if that amount grows in the child's lifetime, it will not be taxed at the child's death. This can save a substantial amount in taxes for your grandchildren.

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3.2.4.2 The Problem: Creditors and Divorce

If you leave assets outright to a child, those assets are exposed to the child's creditors. Even a financially responsible child could have creditors as a result of an accident.

Moreover, although a child's inheritance is the child's separate property even if the child is married, a demanding spouse could pressure your child to make the property into community property. A divorcing spouse could even try to claim that some of the inheritance belongs to that spouse.

Solution

If the inheritance is left in a "Generation-Skipping Trust" to the child, the Trust does not have exposure to the child's creditors. Furthermore, because the Trust is protected against creditors, the child cannot use the Trust assets as collateral for a loan. Many parents feel that this is actually an advantage to the Trust.

Also, the Trust keeps the inheritance segregated from the child's marital property so that it can't inadvertently be changed into community property.

3.2.4.3 The Problem: Control

If you leave assets outright to a child, the child obviously has control over the inheritance. Must the child give up control if there is a "Generation-Skipping Trust"?

Solution

The party in control of the "Generation-Skipping Trust" is the Trustee. If the child is named as Trustee, then the child will still be in control of the Trust assets. Further, you could give the Trustee the power to use Trust income and principal as necessary for your child's reasonable support. If the child is the Trustee, then your child will decide what is reasonable.

You can even give your child the power to change the beneficiaries to receive the Trust principal upon the death of the child.

3.2.4.4. The Problem: Record Keeping

When a child receives an inheritance outright, the principal is not considered income to the child. There is no income tax on the inheritance itself. However, as the child invests the inheritance, income derived from the assets is subject to income tax and is reported on the child's individual return.

If you leave assets in a "Generation-Skipping Trust", then an additional tax return will need to be filed annually. This Fiduciary Income Tax Return (Form 1041) will report the activities of the Trust. Also, a separate record of assets will need to be maintained for the Trust. The Trust will need its own identification number.

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There is no doubt that extra record keeping is involved with a "Generation-Skipping Trust" in order to achieve the benefits, described above.

Conclusion

A "Generation-Skipping Trust" has many advantages. If you have a revocable trust, an amendment to your Trust can be prepared to provide for the "Generation-Skipping Trust". It is important to discuss with your child the fact that the inheritance will come to the child in the form of a "Generation-Skipping Trust".

3.3. Grantor Retained Annuity Trust

You can give away assets, such as stocks, at a discounted value using a "grantor retained annuity trust (GRAT)". After you transfer assets to this trust, you retain an annual payout for a period of years. At the end of that period, the assets go to your heirs. This trust is used for making very large gifts.

3.4. Qualified Personal Residence Trust

You can give away your home at a reduced value using a "qualified personal residence trust (QPRT)". After you transfer your house to this trust, you retain the right to live in the house for a number of years. At the end of the period, you continue to rent the house from the Trust. Using this trust, you can transfer your home for a low value.

3.5 Charitable Trusts

If you would like to sell an asset but hesitate because you would have a large amount of capital gain, consider a charitable trust. You can transfer the asset to the charitable trust and sell it without tax on gain. The trust can pay you an amount annually for a period of years. At the end of that time, the trust passes to charity.

3.6. Testamentary Trusts

You can use a trust to provide management of assets for your heirs.

3.6.1. Minor Children

If your beneficiaries are minor children, they are too young to own and manage assets. You can name a trustee to control the finances and support the beneficiaries until they reach a certain age, for instance, age 25. A child's creditor cannot attach the assets of the trust. You could provide that the trustee distribute one-fourth (1/4) of a child's share to him at age 25; one-half (1/2) at age 30; and the balance at age thirty-five (35), for example.

If you do not create a trust for your minor children, then a legal guardian must be appointed by the court at your death. The court will distribute your estate to the guardian, who must account to the court periodically. About 2% of your estate will be paid each year to the guardian and to the

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attorney. The guardianship will end at age 18, when your child will get the balance, outright.

3.6.2. Special Needs Trust

If you leave your estate to a beneficiary who is receiving government benefits due to a disability, such as Medi-Cal and SSI, then your beneficiary may cease to be eligible for those benefits.

You can create a "special needs trust" for that heir so that the heir will continue to get government benefits. The trust says that the trustee may only distribute money from the trust if government benefits are insufficient to provide for the heir's special needs. The trust property doesn't belong to the beneficiary. Thus, the heir can continue to get the benefits to which he would otherwise be entitled.

4.0. What is a Will?

A Will is a document that designates (1) your heirs, including alternative heirs, and (2) a "personal representative" to settle your estate and distribute your belongings.

4.1. What are the Requirements of a Handwritten Will?

A handwritten will must be on plain paper (no typing or preprinting), signed and dated. A small technicality can void your will or subject it to costly court proceedings. If you have a handwritten will, have a lawyer review it.

4.2. Who is My Personal Representative?

If you have a will, your personal representative is called your executor or executrix. If you do not have a will, the court will appoint a representative, called an administrator.

In selecting your representative, pick someone who is a very good record keeper and who has the time to take over your affairs. Remember, this person will step into your shoes to pay your bills, do your banking, perhaps sell your home and securities, distribute your personal effects, and deal with your heirs at a very emotional time. You can have a personal representative who lives outside of California, but consider the complications of time and distance.

4.3. Distribution

The Will spells out how you want your assets and personal belongings distributed. If you have a trust, the distribution will appear in the trust, instead of the will.

4.4. Why is Title to My Property Important?

You may be surprised to find out that the title to your property controls its disposition. Title takes priority over your will.

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For example, if your assets are in joint tenancy with your son, they will pass to your son at your death. Even if your will directs the equal division of your estate between your son and daughter, the jointly held assets will pass only to your son. Joint tenancy property passes outside of the will.

The same is true of life insurance, annuities, IRA and pensions. These assets pass directly to the named beneficiary and not under the will.

Therefore, it is very important to coordinate how you hold title with your entire estate plan.

4.5. Personal Effects Memorandum

Make a written list of how you want your personal belongings distributed. This list helps prevent the heirs from arguing over jewelry, clothes, furniture and the automobile. Many people never complete this list because it is hard to come to an equal or fair division. However, keeping peace in the family can be more important than an exact equal division.

4.6. Review Your Will

Review your Will with an attorney at least every four years so that you are confident that it is up to date and reflects current laws.

4.7. What if I die without a Will?

If you die without a will, the State of California law of "intestate succession" decides to whom your property will pass. Generally, your estate passes to your closest family relatives: first to your children, then to your grandchildren. If you are married, your community property goes to your spouse; and your separate property is divided between your spouse and children.

5.0. Do I Need a Marital Property Agreement?

Marital property agreements are used in estate planning for two purposes. First, the agreement establishes what you own and control by will. Second, the agreement affects income taxes following a death.

5.1. What do I own?

Your estate plan disposes of your estate. If you are married, what assets do "you" own? Your will disposes of all of your separate property and one-half of the community property. Thus, it is very important to determine which assets are separate property and which are community property.

The property laws that we commonly associate with divorce are the same property laws that work at a death. First, property that you owned prior to marriage is separate property. Also, property you received by gift or inheritance is separate property. Next, earnings during marriage are community property. Assets purchased with those earnings are community property.

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If you or your partner came into the marriage with assets of your own, or if you have received an inheritance, it is time to determine which assets are community and which are separate. You can agree to any arrangement you like, as long as you have an agreement in writing. Needless to say, it is far simpler if the parties agree before marriage in a premarital agreement.

An attorney cannot proceed to write a good estate plan until the parties come to an agreement as to who owns what.

5.2. Income Tax Planning

When you purchase an asset, the cost becomes the income tax basis of the property. If you later sell the asset, the gain or loss following the date of purchase is subject to tax. For example, if you buy ABC Stock for $5,000 and sell for $7,000, there is a gain of $2,000.

If you die owning ABC Stock when it is worth $7,000, then your heirs take the date of death value as the new income tax basis. Thus, their basis would be $7,000. If the heirs sell the stock for $7,000, there would be no gain. This is called "stepped-up basis". Of course, if ABC Stock was $3,000 on the date of death, then they would have a decrease in the basis.

If you are married and ABC Stock is your separate property, then all of the stock gets a new basis at your death. If your spouse dies first, ABC Stock won't get a new basis because your spouse didn't own it.

What if ABC Stock is community property? You only own half of the stock. In that situation, your half of the stock receives a new basis. The surprise is that your spouse's half also gets a new basis equal to your date of death value! The reverse is also true; if your spouse dies first, you get a new basis on the total value of the stock.

For this reason, most couples sign a property agreement declaring whether all of their assets are community property.

6.0. Durable Power of Attorney for Finances

How would someone else manage your affairs or make important decisions for you if you were incapacitated? Sign a durable power of attorney for finances which is a document by which you appoint a legal representative to manage your affairs if you become incapacitated. Be very careful who you select to give your durable power of attorney. You must have complete faith and trust in this person.

7.0. Advance Health Care Directives

Sign an advance health care directive to appoint someone to make health care decisions for you if you become incapacitated. It expresses your wishes regarding life support and health care. This is a separate document from your durable power of attorney for finances. You may wish to appoint one person to handle your financial affairs and another to make health decisions for you.

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8.0. Funeral, Burial and Other Arrangements

Preplanning your funeral and burial can save on confusion and unnecessary expenses.

9.0. Location of Documents

If you should die or become incapacitated, would someone have easy access to your financial and legal documents? You can help this person and your heirs avoid confusion and costly delays by completing a "document locator".

Make sure that the documents for settling your estate are easy to find, such as your estate plan, Social Security number, stocks and bond, and life insurance policies. If you find that these documents are scattered here and there, or are not stored safely, set up a better method for record keeping. If some documents are missing, replace them now. For death or marriage certificates, contact the county in which the event took place.

10.0. Keep Your Spouse Informed

If you should become widowed, you'll need many documents to file for survivor's benefits, such as birth certificates, marriage and divorce records, pension records, and insurance policy numbers. To ensure that you have access to these records and other documents
needed to transfer titles, be sure that both your name and your spouse's name are on the family safe deposit box and that both of you know how to get a complete list of your family's legal and financial records.

Encourage your spouse to inform you about the family assets and liabilities. If you have not had responsibility for check writing and paying the monthly bills, get involved in these tasks. You may find that your spouse is pleased that you will take care of these matters.

11.0. Retirement Plan Beneficiaries

It is critical to review the beneficiary designations for each of your retirement plans. You want to coordinate the beneficiary with your estate plan so that the right person gets the benefits. There are also important income and estate tax consequences to your beneficiary designation.

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