

# Putting Your Estate In Order

**It is a common misconception that estate planning is important for only those with money or who are advanced in age. This myth is a cruel deception. Everyone can benefit by creating an effective estate plan.**

Arranging for the distribution of one's wealth is what estate planning is all about. A critical part of estate planning is creating documents that outline your wishes for distributing your wealth after you die. **Every individual has an estate plan. If you do not have a formal written will or trust, your estate plan is created out of default.** Every state in America has laws governing the distribution of property when a person dies without a Last Will and Testament (i.e., dies intestate). The question is not whether you will have an estate plan, but whether you will have an estate plan of your own selection or one imposed upon you by law.

**Traditional estate planning involves creating a will. By preparing a will most people feel they have effectively safeguarded their family's inheritance. However, this is often a false "peace of mind".** A Last Will and Testament outlines your wishes about the distribution of your property after death, but testamentary documents such as wills usually require probate. In preparing only a will, you may be forcing your loved ones through months, even years, of agony in the probate court.

## Probate

**Probate is the orderly administration of your affairs supervised by the court. Probate is a function of state law and varies from state to state. If you own real property in more than one state, it is probable your estate will be subject to probate in numerous jurisdictions, each imposing their own probate fees.**

Probate comes from the Latin word "to prove". A will must be presented to the probate court and proven to be a valid document. In addition to "proving the will" the probate process also includes:

- Officially confirming the personal representative named in the will or appointing a representative, if necessary.
- Notifying the court of a deceased person's death and informing all involved parties (all potential heirs whether named in the will or not) that probate has started.
- Taking an inventory of all property and appraising its value.
- Paying the deceased person's debts and taxes.
- Preparing a final accounting to the court.
- Distributing the remainder of the deceased's property to the heirs.
- Closing the estate.

## **The Disadvantages of Probate**

**Time Consuming:** The probate process can take several months or as long as several years to complete. The average probate can take about 15 months. In complex situations probate lasting 18 months to three years is not unusual.

**Costly:** Fees to probate an estate can run into the thousands of dollars. In addition, the attorney, the executor, probate referee, and other officers of the court must be compensated. All related probate fees must be paid before any of the decedent's assets are distributed to the family. The average cost of probate is around 5% to 10% of the gross estate (e.g. a \$500,000 estate could cost about \$50,000 to probate).

**Loss of Control:** The probate court controls the entire process. Someone "on the outside" will tell your beneficiaries who gets what and when.

**Lack of Privacy:** All probate transactions are a matter of public record. Anyone can find out the size, contents, and beneficiaries of your estate. This can be embarrassing and frustrating for your family, create disputes, and expose your family to unscrupulous solicitors.

## **A Properly Funded Living Trust Eliminates Probate**

**One of the better estate planning alternatives is a Revocable Living Trust, also called the intervivos (Latin for "while living") trust. A Revocable Living Trust is a simple way to make certain your estate assets are distributed as you desire.**

1. It is "Revocable" because you can change the terms or cancel it at anytime during your life.
2. It is "Living" because the trust takes effect while you are still alive.
3. It is a "Trust" because it creates a place where assets are available for your normal use now and will be available for distribution at your death.

The individual who creates a trust is called the Settlor or Grantor. The individual who manages the assets placed in the trust is called the Trustee. The individual who receives benefit or enjoyment from the assets inside the trust is called the Beneficiary. Even though you transfer legal ownership of your assets to the trust, by naming yourself as trustee of the trust, you keep complete control over your property. You can manage, sell, borrow against, or give away the assets in your trust as you please.

## **Other Advantages of Creating a Trust**

**Apart from avoiding probate there are other advantages to using a Revocable Living Trust.**

- If an illness or accident leaves you incapacitated, your successor trustee can handle your trusts financial affairs without the need of court.
- If the beneficiaries of your trust are minors or others who might not use an inheritance as you intend, the trust can continue to hold the assets until they reach a more mature age, for a specific period of time, or for life.
- If you own real property in more than one state you avoid the expense, time and hassle of multiple probate proceedings in each additional state.
- Currently by using the so called "A-B" provisions in a trust, a husband and wife can pass over 22 million tax free dollars to heirs.
- Trusts are generally more difficult to contest (over turn) than a traditional will. To invalidate a will you must either prove it was signed under duress or that the maker was incompetent on the day it was signed. To invalidate a living trust, you would have to prove it was invalid not only on the day it was signed but each and every day it was in existence thereafter.
- When a will is contested, the assets are frozen and they cannot be distributed until the claim is resolved. Assets placed in a living trust are not automatically frozen pending the outcome of a legal challenge. Anyone wishing to contest the trust must file suit against the trust; in the meantime, the assets in the trust can be used or distributed unless otherwise ordered by a Court.

## Limitations of a Living Trust

**Limitations of Revocable Living Trusts are relatively few, but there are some.**

- For your living trust to work properly, you must transfer the asset you want controlled by the trust into the name of the trust (your name as trustee of the trust).
- Living Trusts usually offer no income tax benefits during your life time as income generated by the assets in the trust during your lifetime are taxed as if they were still held in your personal name and reported on your personal 1040 income tax form. However, there can be significant Capital Gains Tax advantages with a Trust for a surviving spouse, as well as heirs, as they can receive a step-up in basis on property eliminating any Capital Gain upon a sale.
- A living trust provides no protection from your creditors during your lifetime but can protect against creditors of your heirs after your lifetime if the trust contained a spendthrift or other protective clause.
- If a trust sells an asset to a beneficiary at a price less than the assets cost basis, the loss is not deductible. Whereas the same asset sold through probate for a loss can deduct the difference between the cost basis and price sold as a loss.
- Fees for creating a trust are usually more than for preparing a simple will.

## Joint Tenancy

**Many times people try to avoid probate by holding their assets in Joint tenancy. Joint tenancy is the method of putting someone's name (ex. a child) on property or accounts. Any good estate planning attorney should advise you of the possible risks of Joint Tenancy.**

Joint tenancy will avoid probate as long as one of the joint tenants survives. If you are married, taking title to your assets as joint tenants with rights of survivorship, all assets are automatically transferred upon the death of one spouse to the surviving spouse without any restrictions and there is no probate.

For numerous reasons joint tenancy with rights of survivorship should only be used between married individuals. The pitfalls of ownership as joint tenants with someone other than your spouse include:

- Your property is exposed to the creditors of your joint owner.
- You may create gift tax consequences when the asset is transferred.
- As a joint owner you give up some control over your property. (Both joint owners must approve every transaction regarding the property).
- If one joint tenant becomes incapacitated and unable to act the other joint tenant must go to court and become appointed as "conservator" before being able to do anything with the jointly owned assets (a trust protects against this).
- From an income tax standpoint, the death of one joint tenant permits a stepped-up cost basis on only one-half of the jointly-owned property.
- Probate is required when the surviving joint tenant dies (a trust prevents this).

## How a Revocable Living Trust Works

**When you create a Living Trust you transfer ownership of all your assets to the trust. It is a written document that allows you, as the trustee(s), unlimited access to and full control of your assets during your lifetime.**

It also enables you to pass property after your death to family, friends and others. It allows you to appoint someone to make certain your property goes to the loved ones you choose. The estate plan that I draft for you is actually a set of documents that include:

- Revocable Living Trust (Single A, Married A-B, or QTIP; whichever is appropriate)
- Assignment of Personal Property
- Community Property Agreement
- Last Will and Testament
- Durable Power of Attorneys
- Advanced Health Care Directive
- Certification of Revocable Living Trust
- Proper forms to transfer property title into trust.
- Information for Survivors (Final instructions)

## Keeping Your Documents Current & Up-to-date

**Most people do not execute their trust one day and die the next. It is usually many years in the future when the documents are actually used to carry out your wishes and/or distribute your property.**

From the day your documents are executed to the day you die, you will need to review your estate planning documents and possibly make amendments adding new beneficiaries, removing beneficiaries, changing the distribution of your assets, changing trustees...etc. As these changes occur, they must be reflected in your documents.

**Changes to your documents are made in the form of an amendment.**

Amendments should be done formally, meaning that they should be typed, signed and notarized. Generally, an amendment will cancel the prior provision (such as a certain beneficiary) and replace it with the revised provisions (such as a new beneficiary).

**Estate planning is a process, not an event.**

The most important part of your planning is keeping your documents current, so they will indeed do what you intend them to do at the appropriate time.

## Your Personal Estate Plan

**By creating your estate planning documents, you should be able to:**

- Eliminate probate and the emotional trauma that accompanies this costly, time consuming and unnecessary procedure.
- Minimize estate taxes to the fullest extent permitted by law.
- Identify guardians for your minor children.
- Establish a trust for the benefit of your family or others.
- Reduce family conflicts and assure proper distribution of your assets according to your wishes.

- Eliminate or Reduce Capital Gains on Real Property on the death of a spouse.
- Eliminate the need for family members to make difficult decisions relative to your health care in the event you are incapacitated.
- Maintain your privacy and discourage legal challenges.

## Other Documents Needed to Complete Your Estate Plan

### Durable Power of Attorney for Asset Management

Generally accepted statistics tell us that once an individual attains the age of fifty, it is six to eight times more likely they will become incapacitated before they die. This may be for a short period of time, or longer. When we talk about a legal incapacity, we don't mean a broken leg, but rather the inability to make decisions regarding critical issues, such as health care, managements of assets, filing income tax returns, etc.

Unlike a general power of attorney, which has no legal standing if the principal subsequently becomes incapacitated, a Durable Power of Attorney is a specific document that authorizes your designated agent (usually your spouse if you are married) to manage your assets for your benefit, file taxes, etc.

In the absence of a duly appointed legal representative for asset management (called an "attorney-in-fact"), other friends or relatives (even spouses) will have to go to court for what is usually termed a court appointed conservator. Establishing a conservatorship for an adult who becomes incapacitated is a difficult procedure. The procedure is not only complex, it tends to be expensive both in terms of dollars and the emotional toll on the parties involved.

### Advanced Health Care Directive

This is a Power of Attorney for Health Care, combined with a Physician's Directive? Your appointed agent is authorized to give consent for treatment and implement life support provisions according to your instructions, if you are unable to do so yourself.

An "advance health care directive" lets your physician, family and friends know your health care preferences, including the types of special treatment you want or don't want at the end of life, your desire for diagnostic testing, surgical procedures, cardiopulmonary resuscitation and organ donation.

### Declaration of Trust

Under certain very limited circumstances, this Declaration could possibly be helpful after your death if you neglected to transfer a valuable asset to your Trust; it merely confirms that you intended to include all of your assets within your Trust. This Declaration is not a substitute for the requirement that you must transfer ("title") your assets into the name of your Trust in order to avoid a potential probate of those non-Trust assets.

### Certification of Trust

The Certificate sets forth the existence of your Trust and your unlimited right as Trustees to deal with any account or asset held in the Trust. The Certificate acts as a short version of the Trust Agreement and gives any third party all the information required from the Trust without getting into the dispositive provisions, which are (and should remain) confidential.

## Frequently Asked Questions

Over the past few years the Revocable Living Trust has received a lot of press. As more and more people become aware of the downside to probate, talks begin about alternatives, especially the Living Trust. Unfortunately, a lot of misinformation is also communicated. So, to remedy this, we did our best to compile many of the most common questions we received and answered them for you.

### **Q. What exactly is a revocable living trust?**

**It is a separate legal entity set up to care for and manage property or funds for you or for the benefit of another.**

### **Q. If I set up a trust is a Will also required?**

**Yes. A Will, called a "Pour Over" Will, is also drafted in conjunction with your trust. If you fail to transfer all your assets into the trust, the will picks up those assets at the time of your death and transfers them into your trust for distribution. All assets "poured into" your trust by the will must go through the probate process first. Guardians for minor children are also named in the will.**

### **Q. Will my property taxes increase if I transfer my real estate into a trust?**

**No. State law stipulates a special exemption for property placed into a trust for the benefit of the Settlor / Grantor.**

### **Q. Does my tax status change when I create a revocable living trust?**

**No. As long as you are the trustee of your trust (or you are living and someone else is the trustee), any income generated by assets owned in your living trust are taxed as if they were still held in your name and reported on your personal 1040 form. No special taxpayer identification number and no special tax forms are required.**

### **Q. Can I borrow against the assets in the trust?**

**Yes. The trust does not restrict your rights to borrow on assets owned in the trust.**

### **Q. What rights does the surviving spouse have in the trusts assets?**

**This depends on the type of trust. In most trusts, if the surviving spouse is a co-trustee and Settlor, he/she has unlimited rights to buy, sell and transfer assets**

### **Q. Doesn't joint tenancy always avoid probate?**

**No. Joint tenancy does not avoid probate upon the death of the last owner. For instance, if you and your spouse own your house as joint tenants and you die, the house passes to your spouse free of probate. However, when your spouse dies, or if you and your spouse die simultaneously, the property will be subject to probate because there is no surviving joint tenant. Had the house been placed in the living trust, there would not be probate at either death.**

### **Q. Who manages the trust?**

**Usually you name yourself to be the manager (trustee). However, you could name a friend, a child who is not a minor, or a corporate entity, such as a bank.**

### **Q. Are living trusts valid in all 50 states?**

**Yes. A living trust is valid in all states and in most foreign countries.**

### **Q. Will a living trust protect against creditors?**

**No. A living trust is not a creditor protection device because you control it.**

**Q. Will I have to rewrite my trust if my personal circumstances change?**

**Not always - depends on what changed. You can amend your trust as often as you wish. We suggest, after two or three amendments, or if your trust is over 10 years old, you make a "Restated Amendment" incorporating all of your changes into one document.**

**Q. How does the trust end?**

**A living trust is dissolved when all of the assets have been distributed to your beneficiaries or it may be revoked by the Settlor(s) / Grantor(s) at anytime.**

**Q. Can a living trust protect my children from creditors?**

**Yes. If the trust is set up as a spendthrift or special needs trust after your death.**

**Q. Can I appoint a minor child as my Successor Trustee?**

**Not if they are a minor at the time they are to act – must be at least 18 to act as trustee.**

**Q. What is the difference between a "revocable" and "irrevocable" trust?**

**A revocable trust can be changed at any time until a designated event occurs, usually one's death. An irrevocable trust cannot be changed once it has been created.**

**Q. Can the living trust buy new assets without making an amendment to the trust?**

**Yes. Title to any asset purchased after the execution of your trust should be purchased in the name of the trust. That "funds" the asset into the trust.**

**Q. Can a living trust save on income taxes?**

**A living trust does not help you save on your personal income taxes; however, it can help heirs avoid or reduce estate taxes and capital gains as described below.**

**Q. Can a living trust help save on capital gain taxes for a surviving spouse and heirs?**

**Yes. A properly done Trust can provide for a step up in basis at the death of the first spouse. Additionally, your heirs will also receive a step up in basis; possibly eliminating, or at least reducing, capital gains for property sold after being inherited.**

**Q. What is an A-B Trust?**

**An A-B Trust is one version of a living trust that can be used by married couples to minimize or eliminate estate taxes. A Disclaimer Trust is also a Trust that can minimize or eliminate estate taxes. However, these trusts have to be followed to protect you.**

**Q. What is the Federal Estate Tax or Estate Tax Exemption?**

**The federal estate tax exemption as of the year 2021 is \$11,700,000 (this is the amount of your assets which can pass to your heirs "estate tax free"; there is an unlimited deduction for assets passing to a surviving spouse). This exemption is scheduled to "sunset" in 2026 back down to \$5,600,000 million and is subject to change by Congress.**

**Q. How can a Marital Property Agreement / Community Property Agreement reduce or eliminate Capital Gains on my Real Estate after the first spouse passes away?**

**In California, if Real Estate of a married couple is held as Community Property, and one spouse passes away, the surviving spouse receives a STEP-UP IN BASIS on certain assets to the "fair market value". This can be accomplished with a Marital Property Agreement / Community Property Agreement if you have a trust. This type of agreement states that all property is to be treated as Community Property, thereby giving the surviving spouse a full step-up in basis and potentially saving thousands in capital gains should the asset be sold.**

## Estate Planning Terms

**Beneficiary** - One entitled to profit, benefit or advantage from a contract or estate.

**Codicil**- A written addition or amendment to a will.

**Conservatorship** - A formal proceeding in which the court appoints conservator to act on behalf of another in business and/or personal matters.

**Contingent Beneficiary** - One entitled to profit from a contract or estate only upon the occurrence of a specific event, usually one who receives assets at the death of the primary or lifetime beneficiary.

**Decedent** - A deceased person.

**Descendants** - Persons who follow decedent in line of descent.

**Estate** - The assets and liabilities, real and personal property, left by a decedent.

**Estate Tax** - Inheritance tax (See Unified Credit below).

**Execute** - The act of signing and notarizing trust documents.

**Executor (Executrix)** - Person or institution named in a will to carry out the will's instructions.

**Gift Tax** - Tax levied on gifts of property over a certain amount. Currently the Gift Tax exemption is equivalent to the Unified Credit / Estate Tax Exemption described below.

**Intervivos** - "Between the living" or "while living."

**Intestate** - One who dies without a will.

**Issue** - Lineal Descendants.

**Joint Tenancy** - A holding of property by several persons in such a way that any one of them can act as owners of the whole and take the property by survivorship.

**Last Will and Testament** - An instrument whereby one makes a disposition of his property to take effect after his death.

**Life interest** - An interest in property which is to terminate upon the death of the holder (or some other designated person) of the interest.

**Living Will** - A document which formally expresses your wish to forego extraordinary medical treatment when you become terminally ill.

**Marital Deduction** - Exempts from estate tax all property passing from one spouse to the other by reason of gift or death.

**Pour Over Will** - Instrument which provides that property not previously transferred into a revocable living trust is to be transferred at the death of the trustor.

**Powers of Appointment** - Power vested in an individual to make decisions affecting disposition on distribution of assets.

**Power of Attorney** - Formal instrument by which an agent is appointed.

**Principle of Representation** - Permits the descendants of a deceased beneficiary to receive the same share collectively that the deceased beneficiary would have taken if he had been living.

**Probate** - The process of proving a will.

**Probate Court** - Court established for the administration of the estates of decedents, and the control of the adoption and guardianship of minors.

**Revocable Trust** - A trust in which a contingent interest is given to another and in which the trustor retains a present interest, ownership, and control.

**Settlor** - One who creates a trust. Also commonly known as the Trustor or Grantor.

**Sprinkling Power** - The power vested in a trustee to distribute income to others over time.

**Successor Trustee** - Individual who succeeds to the power to manage trust assets.

**Trust** - A right of property, real or personal, held by one party for the benefit of themselves or for another.

**Trustee** - One appointed to manage a trust.

**Trust Protector** - A 3<sup>rd</sup> party that protects the trust, and its purpose, and can make necessary adjustments to the trust if there are changes in law or circumstances.

**Unified Credit / Estate Tax Exemption** - The total credit provided by law which is free of estate taxation per individual. For 2021 it is \$11,700,000 and is scheduled to "sunset" in 2026 back down to \$5,600,000 and is subject to change by Congress.