New Rules / Old Rules, Estate Planning .... a Moving Target. Keeping your eye on the ball.

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I. ESTATE ADMINISTRATION

A. Your Estate

Your "taxable" estate for federal estate tax purposes consists of everything in which you have an interest, including all property which you own in your own name, which you own jointly with others, and over which you exercise control, e.g., all life insurance where you have the right to name the beneficiary, including group term insurance. It also includes assets held in a revocable trust.

Your "probate" estate consists <u>only</u> of those assets which are subject to court administration.

<u>YOUR ESTATE</u>

JOINT TENANCY	BENEFICIARY DESIGNATION	TRUST	WILL
Joint Bank or Brokerage Accounts, Assets held as "joint tenants," "with right of survivorship," or an abbreviation of those words	Life Insurance Pension plans Retirement Accounts Annuities	Assets held in the trust	All assets which are not in a trust, do not pass by joint tenancy and do not pass under a beneficiary designation (unless your estate is the beneficiary)
No probate unless all joint tenants die simultaneously	No probate unless your estate is the beneficiary or all named beneficiaries predecease the owner	No probate, provided title is changed to the trustees of the trust	Probate

B. Traditional Last Will & Testament

A traditional Will disposes of some (but not all) of your property upon your death. Assets subject to disposition under a Will are also usually subject to probate.

C. Probate

Probate is the court supervised process by which your estate is administered upon your death. The court assumes control over your assets, makes sure that your bills are paid, resolves any will contests, and makes sure that estate and income taxes are paid. Your property is then distributed according to the instructions in your will, or according to the laws of intestate succession if you have no will.

A probate conservatorship of the estate is the court supervised process by which your estate, upon your incapacity, is administered by a conservator of the <u>estate</u>. A probate conservatorship of the <u>person</u> allows the conservator, with court supervision, to provide for your personal needs.

As a side note, a guardianship is a court process where someone is appointed by the judge to have the care and custody of a minor child and (if needed) to manage the minor child's estate.

D. Joint Tenancy

Joint tenancy property passes by operation of law to the surviving joint tenant(s). However, joint ownership does not guarantee that probate will be avoided in all circumstances and can create unanticipated problems.

Joint tenancy with right of survivorship is the most common (and often misunderstood) manner in which people jointly own property. Upon the death of one joint owner, the remaining joint owner automatically becomes the sole owner of the property without probate. However, upon the death of the surviving owner (or if all owners die at the same time), the property is subject to probate. Joint ownership merely postpones probate unless the surviving owner does some estate planning.

Creating joint ownership can subject your property to risk of loss. For example, if a widow puts her property into joint ownership with her child, this property is available to the creditors of the child even though the property is really "equitably owned" by the widow. Further, between spouses, holding property in joint tenancy can result in the loss of a full stepped-up basis, as discussed below in Section III.

In some cases, however, following the death of a joint tenant, the surviving joint tenant(s) may receive the property free of the creditor's claims of the deceased joint tenant, which can be important if creditors are an issue.

E. Community Property with Right of Survivorship

This form of title, which applies to real property only, allows spouses to hold property as their community property and also achieve the ease of transfer on death formerly only associated with joint tenancy. It also provides a full stepped-up basis, as discussed below in Section III.

F. Beneficiary Designation

Property which passes to a named beneficiary, e.g., life insurance, IRAs, pensions, retirement accounts, and annuities, is not subject to probate unless the beneficiary is your estate or all named beneficiaries predecease the owner.

It is important that your beneficiary designations conform to and are coordinated with your overall dispositive wishes, and that not only a primary, but also a secondary (or contingent) beneficiary be named.

If the named beneficiary is a minor or disabled party, it will be necessary to first establish a guardianship/conservatorship of the estate in order for distribution to be made unless special provisions are included in the beneficiary designation.

G. Revocable Living Trust

With a living trust, you transfer ownership of your property from your individual name to your name as trustee of your trust so that your assets are "owned" by the trust. Certain assets are never transferred to a trust, such as, for example, retirement accounts. There are no exceptions to this rule. By re-titling all non-retirement assets to the trustee of the revocable trust (you), probate is avoided on the settlor's (the person who created the trust) death. You, as the settlor and trustee of the trust, have absolute and total control of the property in the trust during your life so long as you have capacity. Nothing changes except the manner in which you hold title to your property. The trust is both revocable and amendable during your life.

In the event of incapacity, your successor trustee, named by you in the trust document, steps in and administers your estate without court involvement. No conservatorship is usually necessary.

Upon death, your successor trustee distributes your estate according to your instructions. No probate is necessary because title to all non-retirement assets has been changed to the trustee of your revocable trust.

H. "Pour Over" Will

When you have a living trust, it is also necessary to have what is referred to as a "pour over" will in order to (1) name guardians for minor children, (2) gather assets into the trust which may not have been in the trust at the time of your death, and (3) appoint an Executor.

I. Powers of Attorney

There are two types of powers of attorney: (1) Durable Power of Attorney for Health Care, and (2) General Durable Power of Attorney For Financial Affairs. Both are necessary for a complete estate plan.

The Durable Power of Attorney for Health Care authorizes the individual you designate to make health care decisions for you if you are unable to do so and, therefore, usually avoids a conservatorship of your person.

Most Durable Power of Attorney for Health Care documents also allow you to state your preferences about being sustained on artificial life support or being allowed to die a natural death (formerly known as a "living will"). See, for example, the Advance Health Care Directive Kit published by the California Medical Association (www.cmanet.org) included at the end of these materials.

A General Durable Power of Attorney For Financial Affairs works in tandem with your living trust to avoid a conservatorship of your estate by allowing the individual you designate (called an agent or an attorney-in-fact) to handle your non-trust business affairs and assets during any period of incapacity. Such a Power of Attorney can be drafted to be effective immediately or only upon the incapacity of the signer.

A Uniform Statutory Form Power of Attorney is provided for in the California Probate Code and, if used, requires a third party to pay attorneys' fees if that third party refuses to honor the power of attorney and is ordered by a Court to honor the power of attorney.

J. Same Sex Spouses

In June, 2015, the United States Supreme Court ruled that a state ban on same sex marriages was unconstitutional and in violation of the equal protection clause of the 14th Amendment to the U.S. Constitution. As such, same sex couples are treated the same as opposite sex couples for purposes of the federal estate tax laws discussed below.

II. Estate Taxes

To calculate your taxable estate you must include all property in which you have an interest, including the death benefit portion of all life insurance on your life if you control the policy in any way, e.g., if you have the right to designate the beneficiary. Many people are surprised to discover they are worth more after death than during life. Estate taxes are due and payable 9 months after death and are punitive.

A. Unlimited Marital Deduction

Under current federal law, the Unlimited Marital Deduction allows spouses to give an estate of any value to each other entirely tax free, unless the recipient spouse is not a United States citizen. By using a Qualified Domestic Trust in lieu of an outright gift, the Unlimited Marital Deduction may be available to non-citizen spouses.

B. Applicable Exclusion Amount

The applicable exclusion amount (formerly known as the unified credit) exempts a certain amount of gifts made during your life from federal gift tax and exempts a certain amount of your estate from federal estate tax upon your death. In other words, if you are a U.S. citizen or resident, you will be able to pass a certain amount of your property free from gift tax and estate tax. Generally, any portion of the applicable exclusion amount used for gift tax purposes effectively reduces the applicable exclusion amount that will be available for estate tax purposes.

Starting in 2010, the applicable exclusion amount was raised to $5 million, and the rate of tax on the estate over $5 million was lowered from 45% to 35%. In 2013 the rate of tax was raised to 40% which is where it remains today. The tax bill that became effective on January 1, 2018 temporarily doubles the exclusion amount for estate, gift and generation-skipping taxes from the $5 million base, set in 2010, to a new $10 million base, for tax years 2018 through 2025. The exemption is indexed for inflation, so in 2023, an individual can currently shelter $12,920,000 million in assets from these taxes. With portability, discussed below, and with proper estate planning, a couple can double that amount and could exclude $25,840,000 million for 2023. But, the law sunsets on December 31, 2025, meaning that, absent further Congressional action, the exemption amount will revert to the $5 million base, indexed for inflation.

Federal law allows "**portability**" of the applicable exclusion amount between spouses. The portion of the applicable exclusion amount not used by a deceased spouse's estate (which would be the entire exclusion amount if the deceased spouse's leaves his or her estate to his or her spouse) may be used by the surviving spouse, if certain steps are followed. However, in the case of multiple marriages, portability is limited to only the most recently deceased spouse. In order to take advantage of portability, the executor of the deceased spouse's estate must, among other things, affirmatively elect portability on a timely filed federal estate tax return.

C. Generation-Skipping Transfer Tax

An additional tax called the "generation-skipping transfer tax" is imposed on transfers in excess of the amounts referenced in Paragraph B above to beneficiaries who are more than one generation below the decedent, for example, grandchildren.

D. A/B (Bypass) Trust:

Married couples with estates greater than the applicable exclusion amount may need to do special planning in order to take advantage of the applicable exclusion available to both of them. This type of planning is commonly referred to as an A/B Trust. When the first spouse dies, the survivor already owns half of the community property estate, and this will be held in a revocable trust known as Trust “A,” also known as the Survivor’s Trust. The decedent's half is held in an irrevocable trust known as Trust “B,” also known as the Bypass (or Exemption) Trust. The amount to be transferred to the Bypass Trust cannot exceed the applicable exclusion amount available in the year of death.

In such a case, the use of an A/B Trust can reduce the estate tax to zero. Upon the first death, that portion of the decedent’s estate below the applicable exclusion amount, or the entire estate of the decedent if less than the applicable exclusion, is placed in Trust B. It is a tax-free transfer because of the applicable exclusion available to the deceased spouse. Upon the second death, the assets in Trust B pass to the children or other heirs free of estate tax under the applicable exclusion of the first spouse to die, and the assets in Trust A pass to the children or other heirs subject to the applicable exclusion of the second spouse to die.

So that the surviving spouse suffers no loss of lifestyle, Trust B generally provides that all of the income is to be paid to the surviving spouse, and that the Trustee (who is usually the surviving spouse) may use the “principal” of the trust for the benefit of the surviving spouse’s support, maintenance, health and education.

For this estate planning option to work, the couple must have sufficient assets in their trust. Assets which are not part of the trust, e.g., retirement benefits, are generally not available to fund Trust B at the first death. The retirement account typically passes outside of the trust entirely to the surviving spouse. Only the decedent's half of the trust assets will be available to fund Trust B. As a result, the survivor's estate may result in an estate tax at the second death. Therefore, estates which are "top heavy" in retirement benefits require special planning.

Another non-tax benefit of the A/B trust is that it locks in the ultimate disposition of the deceased spouse’s property, such that the surviving spouse will have no ability to change the disposition of the deceased spouse’s property upon the surviving spouse’s death (for example, to a new spouse). In effect, this gives the deceased spouse “control from the grave.” This is often an attractive alternative for couples with blended families, as it assures that the property of the deceased spouse will go as directed by the deceased spouse, and cannot be changed by the surviving spouse.

E. Disclaimer Trust

A Disclaimer Trust is a technique for taking a “wait and see” approach and differs from the standard A/B Trust in that the B trust only gets used if it is needed. Rather than requiring that upon the first spouse's death, an A/B Trust arrangement be created, and requiring that it be funded with all or a portion of the deceased spouse's estate, the Disclaimer Trust leaves the decision as to whether to create such a trust until after the death of the first spouse. If it is needed, and if a valid timely disclaimer is made, the same estate tax benefits can be realized as with an A/B Trust. The goal is to give the surviving spouse a "second look" based on the circumstances that exist after the death of the first spouse. If the surviving spouse disclaims assets into a Disclaimer Trust, the trust will function like an A/B Trust and provide the same estate tax benefits as an A/B Trust. But if there is no tax reason to use the A/B Trust, the surviving spouse can simply receive the assets outright and not do a disclaimer. These types of trusts are particularly attractive in an environment in which there is uncertainty about whether any estate tax will be imposed on the estate. The flexibility of a Disclaimer Trust carries some risk, in that the tax planning it can provide does not happen by default; rather, the surviving spouse must take steps to complete the disclaimer. Any disclaimer must be completed within nine (9) months from the date of death, and there are a number of steps that precede the actual disclaimer, so the surviving spouse must consult with an estate planning attorney and CPA very soon after their spouse's death.

Another significant difference between the Disclaimer Trust and the A/B trust, is that with the Disclaimer Trust, there is no "control from the grave" as discussed above, so this must be considered if important to the couple.

The portability provisions discussed in section B above, allowing the surviving spouse to use any unused portion of the deceased spouse's unused exclusion amount, may make the disclaimer less useful for estate tax purposes. The surviving spouse may, however, have income or non-tax reasons for disclaiming property.

F. A/B/C (QTIP) Trust

In situations where an A/B trust is desirable for the "control from the grave" purposes discussed above, a third trust, Trust "C" formally known as a "Qualified Terminable Interest Property Trust" (or a QTIP trust) may be appropriate. If created, it will hold that portion of the deceased spouse's estate in excess of the amount that can be allocated to the Bypass Trust.

A QTIP Trust qualifies for the Unlimited Marital Deduction the same as an outright gift to the spouse. However, it allows the first spouse to die to control the ultimate distribution of the property in the trust. Assets in the QTIP Trust will be taxed at the second spouse's death.

The QTIP Trust must provide that all income be paid at least annually to the surviving spouse and may provide that principal may be invaded for the surviving spouse's support, maintenance, health and education.

III. INCOME TAXES

A. Basis

Under current law, when you inherit property that has increased in value over the years, your tax cost ("basis") is typically the value of the asset as of the date of the decedent's death and not what the decedent paid for it. This is called "stepped-up basis." For a married couple holding community property in California, the surviving spouse receives a "step-up" on 100% of the couple's community property. In situations in which a Bypass trust is created on the first spouse's death, assets in the Bypass trust do not receive another step-up on the surviving spouse's death. Under some circumstances, a "Decedent's Trust" may be used instead of the Bypass trust to achieve a second step-up on the surviving spouse's death. These rules were not changed by the tax bill effective January 1, 2018.

B. Joint Tenancy v. Community Property

As stated, current tax law provides that when property is inherited, the recipient receives a stepped up basis. When a surviving spouse inherits joint tenancy property, however, only the half inherited from the deceased spouse receives a stepped-up basis; the half originally owned by the surviving spouse does <u>not</u> receive a stepped-up basis. If the property is held as community property, or as community property with right of survivorship, however, the surviving spouse will receive a stepped-up basis for <u>both</u> halves of the property thereby eliminating all of the gain which accrued prior to the first spouse's death. If the surviving spouse then sells the property, some or all of the capital gain is wiped out by virtue of the property being held community property. By the same token, community property is liable for the debts of the deceased spouse (i.e., lawsuits, etc.). Joint tenancy property is not liable for the debts of the deceased spouse.

C. Community Property Agreement

A married couple may want to consider a Community Property Agreement to confirm that all co-owned property be treated as community property regardless of the manner in which title is held in order to assure the surviving spouse of a stepped-up basis as to the entirety of the property.

It is also the way in which spouses agree that when division of the community property becomes necessary as a result of the death of the first spouse, e.g., in order to implement an A/B Trust plan, the estate may be divided upon either the "item theory" or the "aggregate theory" of community property. In the absence of a written agreement, it might be necessary to use the "item theory," which is restrictive and could result in additional estate taxes ultimately being paid by the heirs.

D. Income in Respect of a Decedent

Not all assets receive a stepped-up basis. Assets which have grown tax-deferred, e.g., tax-sheltered annuities, IRA's, and pension/retirement plans, etc. do not receive a stepped-up basis. The beneficiary will pay income tax (at the beneficiary's rate) as distributions are made from the tax-deferred asset (except for Roth IRAs). This results in a double taxation of these types of assets in that they are subject to both the federal estate tax and income tax.

IV. ADVANCED PLANNING TECHNIQUES

A. Gifting

Transfers made during your lifetime above specified amounts are subject to gift tax. The Applicable Exclusion Amount (currently $12,920,000 in 2023) may be used not only at death, but it may also be used during your life to offset any gift tax due on lifetime gifts. However, to the extent that the Applicable Exclusion Amount is used during your lifetime, it will not be available at your death.

Some advantages of making lifetime gifts are:

- Removal of future appreciation from your estate
- Reduction of income taxes by removal of income-producing assets

Although the value of the gift for gift tax purposes is its fair market value on the date of the gift, gifts made during life do NOT receive a stepped-up basis. The recipient of the gift (the “donee”) takes the donor's tax basis for all purposes, called “carry-over” basis.

1. Annual Exclusion

The Annual Exclusion currently permits you to give up to $17,000 (for 2023) to an unlimited number of donees each year without using any of your Applicable Exclusion Amount. With gift-splitting by spouses, a couple can give $34,000 per year to an unlimited number of donees, e.g., children, children’s spouses, grandchildren, etc. If utilized over a number of years, this can remove a significance amount of assets from one’s estate.

2. Unlimited Exclusion for Medical Expenses and Tuition

There is no limit on the amount which may be given for the payment of another's medical expenses and tuition if the payments are made directly to the provider.

3. “Crummey" Trusts

The Annual Exclusion is available only if the gift is of a present interest, i.e., the immediate right to control and enjoy the gift. Contributions made to a trust (with the exception of qualifying trusts for minors) do not qualify for the Annual Exclusion, unless they are subject to a temporary right of the beneficiary to withdraw the contributed property. This is referred to as a "Crummey" power.

B. 529 Plans

529 plans, legally known as “qualified tuition plans” are tax advantaged savings plans designed to encourage saving for future education costs, and are sponsored by states, state agencies or educational institutions. There are 2 types of 529 plans: prepaid tuition plans and college savings plans. All 50 states and the District of Columbia sponsor at least one type of 529 plan. Some college and universities also sponsor prepaid tuition plans. The tax law effective January 1, 2018 expands 529 plans to cover up to $10,000 in 529 plan withdrawals for tuition for K-12 schools. Qualifying schools include public, private, and religious K-12 schools. Any earnings grow federal income tax deferred and distributions for qualified education expenses are federal income tax free. Contributions to 529 plans qualify for the annual gift tax exclusion, and it is possible to contribute up to 5 years of contributions at once by taking certain steps, which may be a good estate planning strategy. There are aggregate limits which vary by plan.

C. Irrevocable Life Insurance Trusts

An Irrevocable life insurance trust (commonly known as an “ILIT”) is used to shelter life insurance from taxation. Life insurance is included in the taxable estate if the decedent had a right to exercise any control over the policy, such as naming a beneficiary. If the policy is owned by an irrevocable trust, it will pass to the beneficiaries free of income, gift and estate tax. Life insurance owned by an irrevocable trust is often used to provide the funds necessary to pay unavoidable estate taxes.

D. Dynasty Trusts

The generation-skipping transfer tax exclusion provides a unique planning opportunity known as the Dynasty Trust.

E. Qualified Personal Residence Trusts

A QPRT allows you to gift your primary residence or vacation home to your children or other heirs at a reduced value for estate/gift tax purposes while still allowing you the use of your home for your life.

F. Family Limited Partnerships

A Family Limited Partnership allows you to gift assets to your children or other heirs at a reduced value for estate/tax purposes (while still allowing you to control the assets as the general partner) by applying various valuation discounts, e.g., discount for lack of marketability and discount for lack of control.

G. Charitable Gifts

There are many ways to benefit your favorite charity in addition to outright charitable gifts. Gifts of stock or securities directly to a qualified charity allow you, as donor, to avoid capital gains tax on the appreciation of the stock, increasing the value of your gift at a decreased cost to you. If you are 70.5 years old or older, you can make a tax free gift to charity of up to $100,000/year directly from your IRA, and the amount of the charitable gift qualifies for your Required Minimum Distribution. An alternative to direct giving is a Donor Advised Fund. These funds are administered by public charities or other organizations to manage charitable donations on behalf of families and individuals. Charitable Remainder Trusts are ideal for disposing of highly appreciated assets without the payment of capital gains taxes while simultaneously benefitting a charity of your choice. Most large charities have planned giving departments that assist donors to find the most efficient way to make charitable gifts.

H. Ethical Wills

Ethical Wills are not estate planning documents at all, and often take the form of a letter from parents to children or grandchildren, in which parents try to sum up what they have learned in life, and in which they try to express what they want most for and from their children. They write these letters because they believe their life experiences and wisdom they have acquired is just as much a part of the legacy they want to leave their children as are their material possessions. Ethical Wills are not easy to write, nor are they easy to receive or read. They are usually very personal and are often very spiritual documents.

VI. Other Estate Planning Considerations

A. Immature Beneficiaries or Beneficiaries with Special Needs

→ Special needs trust for disabled beneficiaries
→ California Uniform Transfers to Minors Act (CUTMA)
→ Customized trusts designed to meet beneficiary's specific needs.

B. Long term care

C. Social Security and other government benefits

D. Future growth of your estate

E. Importance of working with qualified estate planning professionals