California Consumer Guide to Wills, Living Trusts and Estate Planning

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NOTE: The information contained in this brochure is for residents of the State of California only. It is provided for advice only and cannot be¶ considered as a complete statement of the law concerning all planning options. The laws governing tax and estate planning matters are complex and constantly changing. Should you desire legal advice, please consult with competent legal and/or tax counsel.

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Robert P. Bergman, Estate Planning Attorney and Counselor at Law
Planning for Your Most Important Asset…Your Family

Hi. I'm Bob Bergman. I've lived in Santa Clara County since 1968, and I've been a practicing attorney since 1980. As an attorney, I help families with disability and inheritance planning, including planning to avoid Conservatorship if you become disabled, and Probate at your death. I also help families take maximum advantage of the estate tax and inheritance laws to quickly and inexpensively pass on their property to their children or other heirs after death, which can include planning for asset protection for the inheritance for many generations. Families that have children or other relatives with special needs are also assisted with comprehensive supplemental needs trust planning to preserve an inheritance for the care of the special needs person.

Although my practice emphasizes working with families that have young children, I have clients at all stages of life, including clients who are married and unmarried, those with children and those without children. I am married and the father of twin toddler daughters Giovanna and Sabrina, whose pictures appear on the front page of this brochure. My wife Jennifer A. Lotz is a labor and employment attorney.

I am a Certified Specialist in Estate Planning, Trust & Probate Law, certified by the California State Bar Board of Legal Specialization. To become board certified as a specialist, you must have years of experience in your practice area, pass a competitive examination, have specific continuing legal education in your field of practice, be recommended by your fellow attorneys, and be approved by the Board of Legal Specialization. This reflects my years of experience as an estate planning attorney.

I am also a member of WealthCounsel, an association of estate planning attorneys with approximately 1500 member law firms and nearly 2200 members throughout the country. WealthCounsel attorneys share ideas and planning techniques with each other, and are on the cutting edge of estate planning issues and trends in the United States. Although I practice as a sole practitioner in Santa Clara County, I have access to the combined wisdom and expertise of my fellow attorneys in the WealthCounsel network.

As an attorney who specializes in estate planning, my work is similar to that of an architect designing a dream home for my clients. In our meetings together, I create a "blueprint" for your estate plan that has the features and benefits you request. Then, once the estate plan is designed, I build your estate plan like a contractor, using the sophisticated drafting software available only to WealthCounsel members. Because of this approach, I'm able to custom design each and every estate plan I prepare by hand, assuring that your wishes and needs are met.

On the lighter side, I have sung and acted with several Bay Area performing companies, including the Lyric Theatre (Gilbert & Sullivan Society of San Jose), Lamplighters of San Francisco, the Stanford Savoyards, Mission City Opera, the West Valley Light Opera Association, the Sunnyvale Community Players and the Saratoga Drama Group. I am also an avid amateur military historian and collector of military board games and miniatures.

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<u>Education, Professional Memberships and Licensing</u>

San Jose State University (B.A., "With Great Distinction")
Santa Clara Law School (J.D.)
Certified Specialist, Estate Planning, Trust and Probate Law, State Bar of California Board of Legal Specialization
Member, WealthCounsel, LLC, national organization of estate planning attorneys (www.wealthcounsel.com)
Member, ElderCounsel, national organization of estate planning attorneys (www.eldercounsel.com)
Former Member, Advisors Forum, national organization of estate planning professionals
Former Member, Academy of Special Needs Planners
Former Speaker on estate planning, Foundation for Personal Financial Education and Financial Knowledge Institute
Former Columnist, Times Media newspapers (Santa Clara County) and India Parent magazine
Admitted to practice before California courts, U.S. Tax Court, and U.S. District Court, Northern Dist. of California

<u>Prior Related Training and Experience:</u>

Real Estate Broker and General Counsel, Century 21 LAD Realty; Series 7 and 66 securities licenses; Former Vice President and Business Development Officer, Comerica Bank Trust Department; Financial Planner, MetLife Financial Services

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A Practical Definition of Estate Planning

"I want to control my property while I'm alive, and take care of me and my loved ones if I become disabled. I what give my property to whom I want, the way I want, and when I want.

Furthermore, if I can, I want to save every last tax dollar, professional fee, and court cost legally possible."

Estate Planning involves determining your needs, wants and desires for your property and your family. To carry out your wishes may also involve preparing several legal documents. It may involve planning for a special needs child, a second marriage, a noncitizen spouse, or other special things in your life. Planning may also be needed for a child who has a drug, alcohol or gambling problem or other financial difficulties. Proper planning can also provide for asset protection for the inheritance you are passing on to your children or others.

Whether you are single or married, the preparation of a proper estate plan will help you avoid the expense and time delays of a Probate proceeding, help avoid the need for a Conservatorship if you become incapacitated while still alive, and may also reduce or entirely eliminate the Federal Estate Tax (also known as the "Death Tax") at your death.

About two thirds of people in the United States do not do any Estate Planning at all. In this brochure, you will find out about all of the problems that can happen if you fail to plan. You will also find out some solutions to those problems.

The growth of online websites, software solutions, and many self-help books may give you the impression that estate planning is very simple. You may also get the impression that there are "standard" wills, living trusts, and other legal documents that create an estate plan. Unfortunately, there is no such thing as a "simple" Living Trust or a "simple" estate plan.

Estate Planning is a legal specialty that takes hundreds of hours of study and years of practice to master. Websites, software and books from the bookstore cannot take the place of the knowledge and skills of an experienced estate planning attorney. Also, because any attorney can practice in any area of law without being qualified, many general practitioner attorneys sell "wills and trusts" as part of their law practice. These attorneys, like general practice doctors, are often trying to practice law at a level that is beyond their expertise. An inexperienced general practice attorney trying to prepare a proper estate plan would be like a general practice doctor trying to be a brain surgeon.

If you had a brain tumor, you would not try to operate on yourself. You also would not use just any doctor to do the operation either. You should not try to do your own estate planning or use a general practice attorney for the same reasons. Estate planning is filled with legal issues and other complications that need to be considered. That's why it is important to have a competent, experienced estate planning attorney to guide you.

What is Your Estate?

To start our discussion about estate planning, let's define what is meant by "your estate." First of all, your estate contains all of the things that you own, including the following:

- ✓ Personal residence;
- ✓ Other real estate, such as a second home, commercial buildings, multi-family dwellings, apartments, raw land, and deeded timeshares, etc.;
- ✓ Annuities and life insurance on your life (often overlooked);
- ✓ Retirement plans, such as IRAs, 401(k), 403(b), 457, Keogh Plans, and pension plans;
- ✓ Stocks, bonds and mutual funds owned directly or through a brokerage account, not

including any of these owned in retirement plans;

- ✓ Checking accounts, savings account, money market accounts, and certificates of deposit;
- ✓ Business interests, including any shares owned in a corporation, LLC, LLP, or FLP
- ✓ Stock options
- ✓ Personal property, e.g. furniture, jewelry, clothing, antiques…in other words, all of your stuff.

Second, your estate also includes…

YOUR FAMILY!

That's right. Your spouse or partner, your children, grandchildren, parents, grandparents, aunts, uncles, nieces, nephews, cousins, or even those you choose to make your family – they are part of your estate as well.

Therefore, estate planning includes not only planning for your property, but also planning for those in your family that you care for.

Why Do Estate Planning?

There are several reasons for you to do estate planning. Here are just a few of them:

- ✓ You want avoid a Conservatorship while you are alive if you become disabled;
- ✓ You want to avoid the Probate process for your family when you die;
- ✓ You need guardians for your young children, and you're afraid that they might lose their inheritance;
- ✓ You have a special needs child or other beneficiary;
- ✓ You are concerned about your family fighting over their inheritance;
- ✓ You are worried that your estate might be lost due to an extended nursing home stay;
- ✓ You have a loved one in the hospital in a coma or dying;
- ✓ You are worried that your home or business might have to be sold after your death in order to pay for taxes, debts, or other fees and costs;
- ✓ You are in a second marriage, and you want to make sure that your share of the property passes on to your children or grandchildren and not to those of your spouse;
- ✓ You or your spouse are non-citizens, and you want to make sure that your property can be passed on to them
- ✓ You want to minimize or eliminate the federal estate tax (i.e. the "Death Tax"), preserve your estate, and pass it on to the next generation;
- ✓ You want to pass on your values to your children and grandchildren;

✓ You Want Peace of Mind!

Ultimately, the reasons to do estate planning are specific to each and every family, and no two families are exactly alike.

Here in Santa Clara County where I practice law, families come from a wide variety of cultural, religious, ethnic, and family backgrounds. About one-half of my clients are from countries other than the United States, including India, China, South Africa, Great Britain, the Philippines, Germany, and many others. Many are naturalized U.S. citizens, and many are permanent residents. Because of the many financial, spiritual and cultural differences between these families, estate planning needs to be customized to the specific needs of each family.

In this Consumer Guide, most of the discussion and issues will apply equally to unmarried individuals and married couples, registered domestic partners and unregistered "life partners." Also, many of the issues apply whether or not you have children. Whenever there is something that only applies to married couples or those with young children, I will make it clear.

Estate Planning Option: Do Nothing at All

The Most Popular Estate Planning Option of All

Your first option is to do nothing at all. This is the most popular planning option, “chosen” by 65%-70% of the people in the United States.

There are some definite advantages to doing nothing all:

- ✓ **No Out-Of-Pocket Costs!**
- ✓ **No Lawyers!**
- ✓ **No Paperwork!**
- ✓ **You Don’t Have To Think About Dying!**
- ✓ **You’ll Be Gone, So Why Worry About It?**

If you die without an estate plan in place, this is called dying “intestate.” This means that you have no “Last Will and Testament.” The person who dies is called the “decedent.”

If you die intestate in California, state law has written a distribution plan for your estate. It’s called the “laws of intestate succession.” The laws of intestate succession decide who gets your property, how much they will receive, and when they will receive it. The people who receive your property are called your “heirs.”

The laws of intestate succession generally distribute property to your “next of kin,” or those relatives who are most closely related to you. However, because the laws are very specific, your property could be distributed to distant relatives you don’t even know. Your estate will usually also have to go through a formal legal process called Probate Administration through the Probate Court in the county where you were living. **Probate Administration is described in more detail below**.

Estate Planning Option: Make a Will

If you make a Will, you are said to die “testate.” This means you have a Last Will and Testament that you have written. With a Will, you give instructions to the Probate Court for how you want your property distributed when you die. This can be different from what the laws of intestate succession would indicate. You can also name guardians for your minor children in your Will, as well as waive some costs and expenses that the law might require.

However, like doing nothing at all, having a Will still means your estate often must go through the formal Probate Administration process.

Probate: The Attorney’s Retirement Plan)

In California, administration of an estate through the Probate Court will be required if you die owning property in your name or payable to your estate that is worth at least $150,000 in total value. The total value includes property such as stocks, bonds, mutual funds, and checking and savings accounts.

Even if you don’t have $150,000 of property, Probate is still required if you own California real estate worth at least $50,000. These values only went up on January 1, 2012, and had not changed since I started practicing law in 1980, even though real estate prices have risen dramatically over the past 30 years.

<u>Ancillary Probate Proceedings:</u>

Additionally, if you own real estate in more than one state, there will have to be an “ancillary” or secondary Probate proceeding in each other state where you own real property. This is because each individual state has the right to control the distribution of property within its own borders. Each ancillary Probate proceeding will have its own filing fees, costs, and time delays, which will be different for each state.

In Probate, the Probate Judge will supervise the administration of your estate. Certain types of property can be passed on to your heirs without going through the full Probate process. These include the following:

- ✓ Property held as “Joint Tenants With Right of Survivorship” with one or more other people;
- ✓ Property held as “Community Property” with your spouse or California Registered Domestic Partner;

- ✓ Property held as “Community Property With Right of Survivorship” with your spouse or California Registered Domestic Partner;
- ✓ Life Insurance, annuities and retirement plans that you made payable directly to one or more beneficiaries <u>who are alive at your death</u>;
- ✓ POD (“Pay on Death”) or TOD (“Transfer on Death”) bank or brokerage accounts you owned at financial institutions that you made payable directly to one or more living beneficiaries at your death; and
- ✓ **Property owned by your Revocable Living Trust, either alone or with your spouse**

If you have less than $150,000 of property (which may include real estate worth $50,000 or less) in your name or payable to your estate when you die, that property can be passed on to your heirs by the preparation of a sworn affidavit. This means that no formal Probate proceeding will be required. If you do own real estate worth less than $50,000 as part of the $150,000, then a petition must be filed with the Probate Court to transfer the property. However, a full Probate proceeding is not needed.

NOTE: Your property that passes through Joint Tenancy with Right of Survivorship, Community Property with Right of Survivorship, beneficiary designations, and POD or TOD is <u>not</u> subject to the Probate process at all. This means that you cannot change who receives this property by a Will or Living Trust.

The Probate Process

In the Probate process, a person who has died is called a "decedent." Probate is the court-supervised administration and distribution of a decedent’s property or estate after they die. When a decedent’s estate goes through Probate, the following steps need to occur:

1. Paperwork is filed with the Probate Court, setting a court hearing date. In Santa Clara County, it currently takes approximately 75-80 days until the hearing date;
2. Notice is given to the heirs of the decedent. The "heirs" are those people who will inherit the decedent's property, determined by the laws of the State of California in the Probate Code;
3. On the scheduled court hearing date, the Probate Judge appoints a Personal Representative to handle the decedent's property. The Personal Representative is called the "Executor" if the decedent had a Will (called dying “testate”), and an "Administrator" if the decedent did not have Will (called dying “intestate”);
4. The decedent's property and debts are identified, the decedent's creditors are notified, and the property is then valued by the Personal Representative and a court-appointed appraiser called the “Probate Referee;”
5. The decedent's heirs are identified by the Probate Judge. The Probate Judge follows the decedent's Will if one exists, or the laws of “intestate succession” if there is no Will;
6. Creditors, attorney’s fees, Personal Representative fees and other debts, fees and expenses are paid; then
7. FINALLY – the decedent's remaining property is distributed to the decedent’s heirs

Advantages Claimed for Probate Proceedings

There are several possible advantages for a decedent’s estate in a Probate proceeding:

1. The Probate Court protects the heirs and beneficiaries. If there are any disputes between heirs and beneficiaries, creditors of the decedent, or other issues that arise, the Probate Court is there to supervise;
2. Probate cuts off the claims of creditors after the four-month period following the issuance of “Letters Testamentary” or “Letters of Administration.” Notice of the Probate must be published in a local newspaper that has general circulation in the area where the decedent lived. Anybody who thinks the

decedent owed them money for any reason then has a four-month period in which to file a creditor's claim with the Probate Court. Failure to file such a claim by the creditor within the four month period generally means that the claim is terminated. (Note: This does not apply to secured creditors, such as a bank mortgage);

3. The transfer of title is a public record that prevents potential problems with title companies in the future insuring the transfer of the title: Because the distribution of real estate from a Probate is done by a court order of the Probate Court, a title company is entitled to rely on that judgment;
4. Questions and disputes are settled under the protection and guidance of the Probate Court. The Probate Court is there to act as a referee and final judge of any disputes that arise between heirs, people who think they should have been heirs, creditors, etc.;
5. The Probate estate of the decedent is a separate taxpayer and some tax savings may result (generally not a big issue); and
6. Probate costs may also be deductible for income tax or death tax purposes (also generally not a big issue.)

Costs of Probate

The Dollar Costs of Probate: There are many fees and costs associated with Probate. For example, there are various fees based on the gross value of the decedent's estate, not the net value. For example, if you own a house with a fair market value of $750,000, and you have a $500,000 mortgage on the house, you would consider that to be a $250,000 asset, because your equity in the property is $250,000 ($750,000 market value minus the $500,000 mortgage). However, in Probate Court, the fair market value of your home determines the value of the estate for the calculation of various fees and costs. This is similar to the valuation of a house when it is sold by a realtor, where the realtor's commission is based on the "sale price" and not the seller's equity in the house. That means that, for Probate purposes, your house would be valued at $750,000.

Example: Under current law, a $1,000,000 estate consisting of a house worth $750,000 and $250,000 in bank accounts and investments would have the following anticipated fees and costs:

1. Current Probate Court filing fee of $435.00 and final distribution court filing fee of $435.00;
2. Statutory Attorneys' fees of $23,000, with more fees authorized by the Probate Court if the attorney does "extraordinary" legal services for the estate;
3. Statutory Personal Representative's fees of $23,000;
4. Probate Referee's fee of about $1,000, plus costs; and;
5. Publication fee of $115 to $400 or more for the local newspaper where the decedent lived.

TOTAL COST OF OVER $48,000, OR NEARLY 5% OF THE VALUE OF THE ESTATE!

Other Probate Costs: There are several other costs of Probate, such as:

Lost Privacy

When your estate goes through Probate, everything becomes public record!

- ✓ **Everything you owned**
- ✓ **What your property was worth**
- ✓ **Everybody you owed, and how much you owed them**
- ✓ **The names and ages of your heirs, and where they live**
- ✓ **What assets your heirs will be receiving from your estate**

Because of the completely public nature of Probate, there are unsavory people such as the character to the left who specifically go through the Probate records to locate heirs that may be too young or financially immature to handle their inheritance. They then contact these heirs with investment schemes or other fraudulent plans so that they can separate the heirs from their inheritance.

Lost Time

Probate proceedings can take a very long time. For example, the typical Probate takes from 9 months to 2 years or more! It is not unusual for Probate proceedings to last for several years if there are assets that are difficult to sell or distribute. Because of the length of time of Probate proceedings, this can lead to **lost opportunities for your children or other heirs.** Because your assets are held up in the Probate process for several months or even years, your assets are not available to:

- ✓ Pay tuition for your children's or grandchildren's education
- ✓ Provide money for a child to purchase a home
- ✓ Provide money to start a business or professional practice

Conservatorship (The Living Probate)

There is another problem with having no Will or just having a Will. If you become incapacitated because of a heart attack, stroke, accident, or illness, you may lose the ability to handle your financial affairs. However, even your own spouse or partner will have no legal right to sign your name or handle your business affairs! Instead, they will need to go to the Probate Court and obtain a Conservatorship for you.

A Conservatorship is a guardianship for an adult. The Court appoints two types of Conservator to take care of you, the "Conservatee," and your property. The Conservators can be the same person. The types of Conservator are as follows

Types of Conservators

There are two types of Conservators appointed by the Probate Court – the Conservator of the Person, and the Conservator of the Estate.

The Conservator of the Person: This person is given authority by the Probate Court to make medical and health care decisions for you, including your medical treatment, where you will live, what you will eat, and everything else concerning your health.

The Conservator of the Estate: This person is responsible for gathering together your property, having it valued, accounting for all income and disbursements from your property, and generally taking care of your property. This person also has the legal right to deal with government agencies on your behalf, file and defend against lawsuits, and generally do anything with your property that you could, all subject to court review.

Regular accountings must be filed with the Probate Court, and the Court appoints a Court Investigator to interview your family and friends and the proposed Conservator, which is done on at least an annual basis as long as you are "conserved."

All of the costs of the Conservator are paid out of your assets. Similar to a Probate proceeding, a Conservatorship proceeding has filing fees, notice requirements, attorneys' fees, accounting fees, and other costs associated with it.

Avoiding Conservatorship

Both the Conservatorship of the Person and the Conservatorship of the Estate can be avoided by having, at a minimum, the following documents:

The Advance Health Care Directive: California law makes it possible to grant authority to an individual to make health care decisions for you if you lack the capacity to do so for yourself. Such a situation could occur if you are in a coma or have been declared mentally incompetent by a court of law.

The Advance Health Care Directive is a legal document that is prepared and signed by you while you are alive. It is designed to only take effect when and if you are unable to make health care decisions for yourself. The document is designed to permit you to outline the types of treatment, medications, etc. that you do not want, funeral arrangements, and other special wishes and desires which you may have concerning your health care. Because of the personal nature of the document, you can even appoint a non-relative to make these health care decisions for you. This may be appropriate if you believe that your close relatives would be too influenced by emotion rather than your best interests.

A well-drafted Advance Health Care Directive will be very detailed and will be customized especially for you. It will deal with many more issues than the simple forms (called the "statutory form") that are available through hospitals or physicians. In addition, you may nominate a Conservator for yourself in this document, or in a separate document. A Conservator is similar to a Guardian for a minor child, but instead is appointed by a court to take custody of a legal adult because of physical and/or mental incapacity.

HIPAA Authorization Form: The Health Insurance Portability and Accountability Act, better known as the "HIPAA law," is a law concerned with medical privacy. In the absence of written authority, any health care provider for you cannot reveal any of your confidential medical information to anyone, including your spouse or partner, without running the risk of liability for revealing this information.

The HIPAA Authorization Form provides that written authority, permitting those persons you identify to obtain whatever medical information you authorize.

The General Durable Power of Attorney: California law also makes it possible to grant authority to an individual to handle day-to-day financial matters for you if you lack the capacity to do so for yourself. The General Durable Power of Attorney will enable the person you appoint, called your "Attorney in Fact" or "Agent," to have as little or as much authority as you grant. Your Agent also has the authority to exercise many of your personal rights on your behalf, such as filing or defending a lawsuit, entering into or enforcing contracts, running a business, or dealing with government agencies and programs such as the IRS, Social Security, Medicare, and Medi-Cal.

As with the Advance Health Care Directive, a well-drafted General Durable Power of Attorney will be very detailed and will deal with many more issues than the simple form that is generally available in any stationary store. If both documents are properly drafted and used in conjunction with a Revocable Living Trust, the need for a Conservator may be completely avoided. A Conservatorship will otherwise cost several thousand dollars to establish, and will require regular accountings to be filed with the court on your behalf.

If you wish, your Agent may also make gifts from your property in order to continue a charitable giving program you have, or to reduce your taxable estate for estate tax purposes, to pay tuition for your children or grandchildren, or many other reasons. Properly drafted, your Agent may also be able to do additional estate planning with your assets, and may also be able to engage in long term care planning to preserve some or all of your estate if you need to go into a nursing home.

Estate Planning Option: Use Joint Tenancy Ownership

Effects of Joint Tenancy Ownership

Some people plan their estate by owning everything as Joint Tenants with their spouse, partner, or children in "Joint Tenancy," "or "Joint Tenants with right of survivorship," generally abbreviated as JTWROS or JTROS on banking and brokerage account statements.

Joint Tenancy has many features that make it attractive. First of all, a Joint Tenancy consists of one or more "Joint Tenants" who collectively own specific property, such as a house or bank account. One of the major features of Joint Tenancy is the "right of survivorship," which means that the last surviving Joint Tenant ends up owning all of the property.

Property held in Joint Tenancy does not go through the Probate Court process, but instead passes to the surviving Joint Tenant or Joint Tenants by operation of California law. This means, however, that if a person makes a Will or Living Trust and tries to leave their interest in a Joint Tenancy property, the Will or Living Trust does not control where the property goes – the Joint Tenancy laws take over and distribute the property to the surviving Joint Tenant(s).

Even though Joint Tenancy property passes to the surviving Joint Tenant(s), the deceased Joint Tenant's interest in the property is still part of their estate for purposes of the federal estate tax. This includes not only real estate, but stocks, bonds, mutual funds, brokerage accounts, checking and savings accounts, certificates of deposit, and similar types of property.

IMPORTANT NOTE: Even though Joint Tenancy ownership avoids Probate at the death of the first Joint Tenant, it does not avoid Probate at the death of the surviving Joint Tenant. In fact, Joint Tenancy ownership does not ultimately avoid Probate – it only delays it until the death of the last Joint Tenant!

Income Tax Concept of "Cost Basis" for "Capital Assets"

Property such as a personal residence, stock, bonds, mutual funds, and precious metals are called "capital assets." The sale of a capital asset may trigger an income tax "capital" gain or loss. Whether or not there is a capital gain or loss is determined using the tax concept of "cost basis."

Cost basis refers to the value of capital assets for capital gains income tax purposes, used to calculate a capital gain or loss on the sale of the asset. Typically the cost basis is the purchase price or acquisition price of the capital asset. For example, someone purchasing a home for $500,000 would have a "cost basis" of $500,000. If the house goes up in value and is then sold, the increase in the value of the property over the original cost basis is "capital gain." This may trigger a federal and state income tax on that capital gain. If the property in this example with a cost basis of $500,000 was then sold for $700,000, there is a potential capital gain of $200,000 ($700,000 sale price minus $500,000 cost basis).

"Step Up" in "Cost Basis" On Death of Owner

Under current law, when a person dies their ownership interest in a capital asset generally received an income tax "step up" or increase in the cost basis of the capital asset. This increase in capital gains cost basis permits income tax savings if the property is then sold by whoever inherited the deceased person's interest in the property.

Joint Tenancy vs. Community Property (for Married Couples)

Joint Tenancy ownership of property by a married couple is defined in the law as husband and wife each owning a "divided" one-half interest in the property. Community Property ownership of property by a married couple is defined in the law as husband and wife each owning an "**un**divided" one-half interest in the property. The difference in the ownership definitions can lead to very different income tax results when the first spouse dies.

Income Tax Treatment of Joint Tenancy Property

When a married couple owns property as Joint Tenants, the Surviving Spouse will generally receive a "step up" in the cost basis of the property equal to the "divided" share of the spouse that died. For example, if real estate was originally purchased for $200,000 (the "cost basis") and is now worth $500,000, the equity in the property would be $300,000. The divided interest of each spouse would be equal to $150,000. Therefore, at the death of the first spouse, the Surviving Spouse would receive a new cost basis calculated as follows:

$200,000 original cost basis + $150,000 equity interest of Deceased Spouse = $350,000

If the property were then sold for the fair market value of $500,000, the Surviving Spouse would have a potential taxable gain of $150,000 (i.e. the Surviving Spouse's share of the equity), at combined California state and federal capital gains tax rate of up to 24%. This would be around $36,000 in income taxes. A better alternative can be found in the next section.

<u>Income Tax Treatment of Community Property</u>

Property owned as Community Property by a married couple has many differences with Joint Tenancy:

1). Each spouse may dispose of his or her share of the Community Property by Will or Living Trust;

2). Community Property will be subject to Probate (although there is a simplified procedure in the Probate Code which permits the rapid transfer of Community Property to the Surviving Spouse without the need for a full-length Probate proceeding); and

3). When property is held as Community Property, the Surviving Spouse will receive a better "stepped-up" cost basis than when the property is owned as Joint Tenants. In fact, the benefit will be so much better that Joint Tenancy ownership should not even be considered by a married couple!

When a married couple owns property as Community Property, under the law it cannot be determined which half of the property was owned by the Deceased Spouse, because the ownership is <u>an undivided one-half interest!</u> This means that when the first spouse dies, the tax law treats each half of the property as being owned by the Deceased Spouse. Using the previous example of a property purchased for $200,000 that is now worth $500,000, the equity in the property is still $300,000. However, the <u>un</u>divided one-half interest of the Deceased Spouse is equal to <u>each half of the property.</u> Therefore, at the death of the first spouse, the Surviving Spouse would receive a new cost basis calculated as follows:

$200,000 original cost basis + $300,000 equity interest of Deceased Spouse (both halves of the property) = $500,000

If the property were then sold for the fair market value of $500,000, the Surviving Spouse would have a potential taxable gain of $0! This will save around $36,000 in income taxes. A better alternative can be found in the next section.

This does not appear to make sense at all. How can the Deceased Spouse own 100% of the equity at death? As indicated above, it is the way that Community Property is defined in the law. The Deceased Spouse is treated as if he or she owned 100% of the property at death. This means that 100% of the value of the property is "stepped up" at the first death. Clearly, ownership as Community Property is more beneficial than Joint Tenancy ownership for a married couple.

It should be emphasized at this time that the above potential income savings apply to any appreciating capital asset held by a married couple in California as Community Property, including real estate, stocks, bonds, classic automobiles, jewelry, china, silverware, etc. **Note, however, the "step up" in basis does <u>not</u> apply to capital assets held inside of retirement plan, such as IRAs and 401k plans.**

<u>Community Property with Right of Survivorship (CPWROS)</u>

This form of ownership is only available to married couples. Ownership in this form has a right of survivorship similar to Joint Tenancy, but Community Property treatment for other purposes.

Property held in this form of ownership <u>may</u> have the tax benefits of Community Property, specifically the 100% "step up" in cost basis discussed above for Community Property, although that is not clear under Federal law. The term "Community Property" is defined by the

Internal Revenue Service as eligible for the benefits of a full "stepped up cost basis" to the current fair market value. The term "Community Property With Right of Survivorship" is not defined by the Internal Revenue Service.

"Joint Tenancy With Right of Survivorship" is also defined by the Internal Revenue Service. Because CPWROS property is similar to Joint Tenancy ownership with the "survivorship" feature described above, the concern is that the Internal Revenue Service will treat CPWROS property in the same way as Joint Tenancy property for income tax purposes when it comes to the "step up" in cost basis discussed in the previous two sections of this brochure.

Because of the uncertainty in the law, I do not recommend this form of ownership for married couples in the State of California.

IMPORTANT NOTE: Property owned by a married couple in Joint Tenancy or a form of Community Property may possibly avoid Probate on the first death, but will not avoid Probate on the second death unless steps are taken to remove the property completely from the Probate process. The Revocable Living Trust can accomplish all of the benefits of these forms of ownership, without any of the detriments.

Estate Planning Option: Use Beneficiary Designations

Beneficiary designations include assets where you can actually name one or more beneficiaries to receive the assets upon your death. Typical assets include retirement plans such as Individual Retirement Accounts (IRAs), 401(k) plans, 403(b) plans, 457 plans, pension plans, and annuities. They may also include checking accounts, savings accounts, certificates of deposit, money market accounts, brokerage accounts and, in some states, real property as well.

Beneficiary designations, while useful for small value assets, can create a lot of problems when used as the sole means of estate planning. For example, while it may seem obvious, for a beneficiary designation to work properly, the person named as the beneficiary has to survive the person who owns the assets. If the beneficiary does not survive the owner, and there is no contingent or secondary beneficiary named, then the asset will probably end up payable to the owner's Probate estate. It may then pass by the laws of intestate succession inheritance to more distant family members or may even pass to a family member who the owner specifically did not want to receive the asset.

As another example of the wrong person receiving the asset, take the following example: Husband names wife as beneficiary of his life insurance. Later, the couple gets divorced, however, husband fails to change the beneficiary of his life insurance. Under California law, beneficiary designations on retirement plans and bank accounts are revoked as a matter of law when a couple gets divorced, but not in the case of life insurance. If the husband get remarried and fails to change the life insurance beneficiary, the proceeds will go to the first wife instead of the second wife. Probably not the result the husband intended!

Furthermore, if assets name a minor beneficiary to receive the asset, this will trigger a Guardianship proceeding for the property. The property will then be held until the minor beneficiary reaches age 18 years, when it will be turned over, free of any conditions or restraint. Probably not the best result for an 18-year old to receive an inheritance outright.

Estate Planning Option: Using a Revocable Living Trust

In my opinion, the best and most flexible estate planning option is to use a revocable living trust. A revocable living trust is a contract that is made between the owner of property (the "Trustor") and a "Trustee," named by the Trustor of the property to handle the property during the Trustor's lifetime.

The living trust is "revocable," which means that the Trustor may amend, modify, change or even revoke the living trust at any time. There are several types of living trusts available. They are described below:

The Sham Trust

This type of living rust is sometimes known as a "Constitutional Trust," "Pure Trust," or "Contract Trust." The promoters of this type of trust claim that it avoids the payment of all taxes to the federal government. It sounds too good to be true, and it is too good to be true. Using this type of trust will only end up with you in jail for tax evasion.

The "Bare Bones" Living Trust

This type of living trust is familiar because it is very common. Suzie Orman, Nolo Press, legalzoom.com – all of these are sources for "do-it-yourself" living trusts. You can also get books at Barnes and Noble or Borders to make your own living trust, or pick up software in the bargain bin at Office Depot or online.

I call these "bare bones" living trusts, because they are typically very incomplete, and often will not survive legal challenges after someone had died. Like a skeleton without any muscles or skin, they will often collapse in a heap when tested. Unfortunately, the test will come after someone has died, when it is too late to make changes or correct the problems.

These planning options have the following in common:

- ✓ **They prepare "one size fits all" documents with no customization, and they don't reflect the specific needs and wishes of your family**
- ✓ **They are cheap, and you get what you pay for**
- ✓ **They can't ask you questions that need to be asked**
- ✓ **They can't legally answer your questions**
- ✓ **They miss many important issues**
- ✓ **They accept no legal responsibility if something goes wrong and their plan doesn't work!**

The fact is that, no matter how much you read about living trusts, no books, websites or software alone can guide you into creating a living trust estate plan that is appropriate for you and your family. Books, websites and software can't ask you the important, hard questions, and they can't answer questions about your specific situation. Only a trained, experienced estate planning attorney can do that.

The "Trust Mill" Trust

There are many companies that come through communities offering free living trust seminars in multiple locations. They will advertise cheap "Living Trust Packages," or amazing discounts on fees. In the small print on their ads, it will often read "your living trust package will be delivered to you by a licensed insurance professional."

These companies are interested in only one thing – access to your financial information. The living trust package is designed to provide them with that information so that they can sell you costly annuities or mutual funds. They are not really any better than the "bare bones" living trust.

The Fully-Funded Revocable Living Trust

The best living trust solution is a fully-funded revocable living trust prepared by an experienced estate planning attorney. "Fully-funded" refers to the legal concept of "funding" a trust, which means the transfer of property into trust ownership.

Who Should Prepare Your Living Trust Estate Plan for You?

Be careful about having your living trust estate plan prepared by an attorney who advertises that they do Wills and living trusts, as well as bankruptcy, personal injury, divorce, general business, or several other additional areas of practice. Estate planning is a specialty, and you need to work with somebody who devotes all or a substantial part of their practice to estate planning.

Just like you would not have your general practice doctor do surgery on your brain, you should not use just any attorney to prepare your estate plan for you. There is no legal requirement that an attorney be specially trained to prepare Wills and living trusts and offer them to the general public. Many general practice attorneys prepare Wills and trusts, often after attending a seminar and buying some forms to use. These attorneys are usually <u>not</u> estate planning attorneys, and will not be able to assist you in the special planning needs for you and your family.

You should use an experienced estate planning attorney who devotes all or a substantial part of his or her practice to estate planning, such a board certified Specialist in Estate Planning, Trust & Probate Law who is also a member of WealthCounsel, a national association of attorneys who specialize in estate planning using proprietary software to draft custom plans for their clients.

I am both a Certified Specialist in Estate Planning, Trust & Probate Law, and a member of WealthCounsel.

The Revocable Living Trust: An In-Depth Discussion

The Revocable Living Trust is an estate planning tool with tremendous flexibility and potential for individuals and married couples for avoidance of Probate and Conservatorship. For married couples, it can also help to minimize or even eliminate the federal estate tax, often called the "Death Tax.," which is discussed later in this brochure. For individuals and most married couples, the avoidance of Probate and Conservatorship are the major benefits.

Probate and Conservatorship Avoidance Using the Revocable Living Trust

As previously discussed, the Probate laws of the State of California require a Probate proceeding when a person dies owning real property worth at least $50,000, or has other property in their name worth at least $150,000 in total value. Property owned by a revocable living trust is <u>not</u> subject to a Probate proceeding, because under the Probate laws, such property is not considered to be owned by you when you die <u>for the purpose of Probate only!</u> As such, the Probate Court does not need to be involved in the ultimate distribution of the property to your heirs or beneficiaries.

Even if all of a person's property in California is not owned by their revocable living trust, it still may be possible to have their property declared to be part of their living trust by the Probate Court without going through a formal Probate proceeding. This may be possible if there is a <u>schedule of assets</u> attached to the living trust that identifies the bank accounts, real estate, brokerage accounts, etc. that you intended to be owned by your trust. Additionally, it may be possible to have a Probate Court order such property to be turned over to your living trust by using a special type of Will called a "Pour-over Will" that is typically prepared at the same time as your Living Trust. In Santa Clara County, this type of legal relief is regularly granted by the Probate Court. Other county Probate Courts may still require a full Probate proceeding.

By using a revocable living trust combined with a well-drafted General Durable Power of Attorney and Advance Health Care Directive (described above), you can generally avoid the need for a Conservatorship for you as well.

The Federal Estate Tax: (the "Death Tax")

For some families, there is another issue that may affect them when someone dies in the United States and owns property anywhere in the world . It is called the federal estate tax, often called the "Death Tax."

When you die, the federal government imposes a tax on the value of your assets that you owned. Some states also impose an inheritance tax on your estate as well. California does not have an inheritance tax.

The federal estate tax affects U.S. Citizens, non-citizen residents, and even certain property owned by nonresidents of the United States that is located in the United States at time of death.

The Death Tax is a progressive tax, which means the larger the value of your estate, the higher the tax rate becomes. In 2009, the maximum tax rate was 45% of your estate, if your estate was greater that $3,500,000 in value at your death. The Death Tax was repealed for 2010, and was scheduled to return to rates from 41% to as high as 55% in 2011, with an exemption of $1,000,000 of estate.

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (TRUIRJCA)

In December of 2010, Congress passed and the President signed the "Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010" (TRUIRJCA), which I will refer to as the Tax Relief Act of 2010 or TRA-2010. Among other things, this new law put the Death Tax back in place for 2010 with a $5,000,000 exemption. It also extended the Death Tax through the end of 2012, again with an Applicable Exclusion Amount (AEA) or exemption from the tax of $5,000,000 for tax year 2011 and $5,120,000 for tax year 2012. However, TRA-2010 also gave the option of using the 2010 tax law with the repeal of the Death Tax for the estates of those persons dying in 2010. The new law also put back in the old capital gains "stepped up" basis rules that had been changed for 2010. The reasons why an estate might decide to be covered by the law of 2010 are beyond the scope of this brochure.

Because of the TRA-2010, the Death Tax laws for the next two years will be as set forth in the following discussion. The laws are set to expire again at the end of 2012, and Congress will be fighting again about what will happen in 2013 and thereafter.

The Unlimited Marital Deduction

In the case of a married couple, if one of the spouses dies (i.e. the "Deceased Spouse") and leaves some or all of his/her property to the spouse that survives (i.e. the "Surviving Spouse"), then the Surviving Spouse will qualify for a special Death Tax benefit called the Unlimited Marital Deduction. The Deceased Spouse's property can be left outright to the Surviving Spouse, or in some form of irrevocable (i.e. "unchangeable") trust that permits the Surviving Spouse to have the use and benefit of the Deceased Spouse's property without having the right to decide the who will eventually receive the property when the Surviving Spouse dies.

The Unlimited Marital Deduction or "UMD" will apply if the Surviving Spouse is a United States citizen or a permanent resident of the United States. In the case of a United States citizen, the UMD is automatic, and it means that an unlimited amount of property can be left to the Surviving Spouse from the Deceased Spouse's estate without any Death Tax.

In the case of a non-citizen Surviving Spouse, the UMD may only be used if the property is placed into a type of irrevocable trust called a Qualified Domestic Trust, or QDOT. The QDOT provides that the property of the Deceased Spouse can be used to benefit the Surviving Spouse that is a non-citizen for his or her lifetime.

If the Unlimited Marital Deduction applies, there is no Death Tax imposed on the Deceased Spouse's property when it passes to the Surviving Spouse. In other words, an unlimited amount of property of the Deceased Spouse can be passed on to the Surviving Spouse, and it acts as a deduction from the value of the Deceased Spouse's taxable estate for Death Tax purposes.

The effect of the Unlimited Marital Deduction is to defer the Death Tax until the death of the Surviving Spouse. When the Surviving Spouse dies, their own property and the property that was received from the Deceased Spouse, whether outright or in some form of trust, is added together to determine the value of the Surviving Spouse's Death Tax estate. If the estate is then passed on to the Surviving Spouse's heirs, a Death Tax might be owed if the estate is too large.

The "Death Tax" Applicable Exclusion Amount

The current Death Tax laws for residents of the United States grants an exemption from taxation of a certain value of estate, technically called the Applicable Exclusion Amount or "AEA." In 2008, the AEA was an estate valued at $2,000,000 or less. In 2009, the AEA increased to $3,500,000. This AEA covers transfers at death to people other than your Surviving Spouse who is a U.S. Citizen, such as your children, non-citizen spouse, or other heirs.

In 2010, we had what I called the "Year of the Dr. Kevorkian Estate Planning Opportunity." For this year, for one year only, the Death Tax was repealed, meaning that there was no Death Tax for one full year. The family of New York Yankees owner George Steinbrenner will not have to pay any Death Tax, nor will the families of at least three other billionaires who died in 2010.

Congress and "Fantasyland"

Even though the Death Tax was repealed for 2010, as noted above, the passing of the Tax Relief Act of 2010 reinstated the tax for 2010 and at least through the end of 2012. For the next two years, there will be a $5,000,000 AEA for 2011 and a $5,120,000 AEA for 2012, with a tax rate of 35% for estates greater than those amounts. Without the TRA-2010, the Death Tax would have returned with an AEA of only $1,000,000, and tax rates of 41% to 55%.

In the "Fantasyland" world of the United States Congress, these laws can be changed at any time, provided there is the Congressional desire and will to do so, enough votes in both the Senate and the House of Representatives, and the President does not veto the changes. The fact remains that, even though the current AEA is $5,000,000/$5,120,000, under the TRA-2010 this is only in effect for the next two years, and is set to "sunset" or expire at the end of 2012. This means that the $1,000,000 AEA and tax rates of up to 55% are scheduled to return on January 1, 2013, just like they were scheduled to return on January 1, 2011 before the TRA-2010 was passed in mid-December of 2010.

Our country has a $14+ trillion dollar deficit, and Congress may be looking for ways to raise more tax dollars. Congress has two years to act before 2013 and the next change in the Death Tax laws, but, if history is any indication, they will likely wait until just before or just after the 2012 Presidential and Congressional elections.

So, we have "certainty" concerning our Death Tax laws for the next two years. However, unless you are planning to die in the next two years, there is no way to predict the following:

- ✓ **When you will die**
- ✓ **If there will still be a Death Tax and, if so, what the AEA will be at that time**
- ✓ **What the Death Tax rates will be at that time**
- ✓ **What you will own at that time**

The "Typical" Revocable Living Trust for Married Couples

The typical Revocable Living Trust historically prepared in California is often called an "A-B Marital Trust." This type of Trust will name the Husband and Wife as the Trustors (i.e. those establishing the Trust), and the Trustees (i.e. those in charge of the Trust and its property), and the Beneficiaries (i.e. those receiving the benefit of the Trust).

This typical Trust will provide that, upon the death of the first spouse (i.e. the "Deceased Spouse"), the Trust either will be or may be divided into two or more trusts to be administered separately from that day on. One or more of the trusts will for be the benefit of the children of the marriage or other heirs of the Deceased Spouse, while one or more of the trusts will be for the benefit of the remaining spouse, or the "Surviving Spouse."

Whether or not the A-B Marital Trust <u>requires</u> a division of the couples' property into two or more trusts or <u>permits</u> a division depends on how the trust is drafted. Most revocable living trusts drafted in the 1980s and 1990s <u>required</u> the division of the property into two or more trusts after the death of the Deceased Spouse. As will be seen in a later section, this may or may not be the best solution for many families.

What is "Trust A" in an A-B Marital Trust?

"Trust A," or the "Survivor's Trust," is established for the Surviving Spouse. It typically contains the one-half of the Community Property owned by the Surviving Spouse of the marriage, plus any separate property that was owned by the Surviving Spouse. It may also contain property that was received from the Deceased Spouse's estate. The property from the Deceased Spouse's estate will likely qualify for the Unlimited Marital Deduction to avoid any Death Tax liability, discussed earlier in this brochure.

The Survivor's Trust is "revocable," which means that the Surviving Spouse may amend, cancel or modify the terms of the Survivor's Trust if desired.

On the death of the Surviving Spouse, the Survivor's Trust will usually add its property to the property owned by Trust B. The property from the Survivor's Trust will then qualify for the Death Tax AEA of the Surviving Spouse in effect in the year of death.

For property that is not already in a revocable trust when the first spouse dies, there are backup "Pour-Over Wills" which will place such property through Probate if necessary, and then "pour it over" into the Revocable Living Trust for division into Trust A and Trust B.

What is the "Trust B" in an A-B Marital Trust?

"Trust B" or the "Family Trust" or "Bypass Trust," will likely contain the Deceased Spouse's one-half of the Community Property, plus any separate property owned by the Deceased Spouse. However, the total value of property that can be placed into the Bypass Trust without a Death Tax is limited to the Death Tax AEA. The AEA will be determined in the year of the Deceased Spouse's death.

The AEA for 2011 and 2012 will be $5,000,000 and $5,120,000, respectively, but is scheduled to drop to $1,000,000 on January 1, 2013.

The Bypass Trust is intended to "bypass" taxation in the estate of the Surviving Spouse when the Surviving Spouse dies. However, the Bypass Trust has a lot of features and benefits for the Surviving Spouse that have nothing to do with taxation.

<u>Irrevocable</u>. First of all, the Bypass Trust is an <u>irrevocable</u> trust, which means that it cannot be changed after it is created. The Surviving Spouse is typically given the right to receive lifetime income from the Bypass Trust, and principal as well if needed in order to maintain the Surviving Spouse's lifestyle.

<u>HEMS Distributions.</u> Distributions from the Bypass Trust are generally limited to those needed for the Surviving Spouse's health, education, maintenance and support, which I abbreviate as "HEMS." In a well-drafted revocable living trust, the Bypass Trust may also grant the power to make distributions to the Surviving Spouse for any reason, and not just for the Surviving Spouse's needs for "HEMS."

<u>Asset Protection</u>. The Deceased Spouse's property placed into the Bypass Trust can also be protected against creditors of the Surviving Spouse, which is another important feature of the Bypass Trust. Because the Surviving Spouse does not own the property in the Bypass Trust, and because of the limits on the distribution of the property for the Surviving Spouse's HEMS needs, it is difficult for a creditor of the Surviving Spouse to take any of the property in the Bypass Trust. This can provide significant asset protection for the Surviving Spouse, especially if the Surviving Spouse is in a high-risk profession such as a doctor, lawyer, accountant, or architect.

For purposes of income taxes and the Death Tax, property placed into the Bypass Trust is not treated as being inherited by the Surviving Spouse. Instead, the ultimate beneficiaries of the Bypass Trust on the death of the Surviving Spouse are treated as the inheritors of the Bypass Trust property. At the death of the Surviving Spouse, the Bypass Trust is <u>not</u> counted as part of the Surviving Spouse's Death Tax estate, and is not subject to the Death Tax as a result. This is why the Death Tax AEA is used – to avoid the payment of Death Tax.

What if There Would be No Death Tax?

Even if there would be little or no chance of a Death Tax being owed by a couple because their property value is below the amount of one AEA, there are other reasons to consider creating a Bypass Trust. For example, in addition to the asset protection discussed above, dividing the estate can protect children's inheritance from being intentionally or accidently left to a new spouse if the Surviving Spouse decides to remarry.

<u>Limited Power of Appointment</u>. Even though the Bypass Trust is irrevocable, the ultimate beneficiaries of the Bypass Trust property might be changed at the death of the Surviving Spouse. This can happen if the Surviving Spouse is given a "limited power of appointment" to direct the distribution of the Bypass Trust property. A limited power of appointment can be used to change the beneficiaries of the Bypass Trust, change the amount or percentage the beneficiaries will receive, or even change the way the property is passed on to the beneficiaries. What can be changed depends on the actual grant of power given to the Surviving Spouse by the Deceased Spouse.

The Typical A-B Marital Trust May No Longer Be Appropriate For Married Couples

Because of the major changes in the federal Death Tax laws since 2001, and the constantly changing AEAs, the "typical" A-B Marital Trust may no longer be appropriate or even necessary for many couples. This is because one Death Tax AEA may be more than sufficient to cover the value of a couple's entire estate, often reducing or even eliminating the need to divide the property at the death of the Deceased Spouse.

For example, even though the Death Tax AEA is scheduled to return to the level of $1,000,000 in 2013 under the TRA-2010, many couples have a condominium or townhouse worth $400,000 to $500,000, and a couple of hundred thousand dollars in investments. It is not likely that the value of such an estate would be greater than $1,000,000, but the typical A-B Marital Trust would require the Surviving Spouse to divide the estate at the death of the Deceased Spouse, creating an administrative burden that may not be necessary.

Planning Flexibility for The Revocable Living Trust May Be Appropriate

If you have a smaller estate, you may want your revocable living trust to permit a high degree of flexibility to decide whether or not to use some or all of the Death Tax AEA of the Deceased Spouse. As such, there is no such thing as a "generic" estate plan that is suitable for every family.

Two planning alternatives for the revocable living trust involve giving authority to either the Surviving Spouse or the Personal Representative of the Deceased Spouse to decide where the

Deceased Spouse's property will go after the Deceased Spouse's death. Both of these alternatives give some planning flexibility after the Deceased Spouse has died.

One Option for Flexibility: Spousal Option Trust Planning For Married Couples

Because of the ongoing uncertainty of the Death Tax laws, especially in reference to what the Death Tax AEA will be when you die, a planning option that is very useful is what I call the "spousal option" trust. It is also called "disclaimer" planning.

In this approach, a married couple has an A-B Marital Trust prepared, but it provides for the following:

- ✓ All of the Deceased Spouse's property is left to the Surviving Spouse, either outright or in some form of revocable or irrevocable trust;
- ✓ If the Surviving Spouse decides that some or all of the Deceased Spouse's property should go to the children, then the Surviving Spouse is given nine months from the date of death of the Deceased Spouse to "disclaim" that property; and
- ✓ Any property that is properly "disclaimed" by the Surviving Spouse will typically be directed into a "Trust B" Bypass Trust for the benefit of the Surviving Spouse and the children. Such property will qualify to avoid Death Taxes up to the Death Tax AEA in effect in the year the Deceased Spouse died.;

Drawbacks of the Spousal Option Trust

Because the Surviving Spouse is entitled to receive all of the Deceased Spouse's property, even if the Surviving Spouse decides to "disclaim" some or all of the property into a Bypass Trust, there is no asset protection for the property that ends up in the Bypass Trust. This is because the property in the Bypass Trust is considered to have been owned by the Surviving Spouse, who then directed it to be placed into the Bypass Trust. This means that if the Surviving Spouse has debts or is sued and has a large judgment, creditors can actually get to the property held in the Bypass Trust even though it is not owned by the Surviving Spouse.

The disclaimer approach provides maximum estate planning flexibility for the Surviving Spouse, because the Surviving Spouse can decide whether or not there are either tax or non-tax reasons to exercise the "disclaimer" to put some or all of the Deceased Spouse's property into a Bypass Trust. However, the price of this flexibility is that there is no asset protection for those assets if the Surviving Spouse is sued. Also, the Surviving Spouse cannot be granted any power of appointment over the assets of the Bypass Trust, even a limited power of appointment. If a power of appointment is granted, all of the assets in the Bypass Trust will be considered part of the Surviving Spouse's Death Tax estate at death, and subject to the Death Tax. This is obviously a result that needs to be avoided.

Another Option for Flexibility : The "Clayton Election" for Married Couples

With disclaimer planning, there are problems with both asset protection and the ban against giving the Surviving Spouse any flexibility to redirect assets of Bypass Trust through the use of a limited power of appointment. Having the asset protection and the limited power of appointment may be desirable as a way to do further estate planning with the Deceased Spouse's assets up to several years after the death of the Deceased Spouse.

Another approach to A-B Marital Trust planning is to use what is called the "Clayton Election." This planning approach is named after a Tax Court case with the same name, and it provides maximum asset protection for the Surviving Spouse with less flexibility than the disclaimer planning.

Using this approach, the property of the Deceased Spouse is actually left to a Bypass Trust. However, if desired, the Personal

Representative of the Deceased Spouse named by the Deceased Spouse's Last Will and Testament can "elect" to treat some or all of the Deceased Spouse's property as QTIP property. For the election to work properly, the Surviving Spouse should not be the Personal Representative of the Deceased Spouse for the purpose of making the Clayton Election.

"QTIP" stands for **"Qualified Terminable Interest Property."** "Qualified" refers to the fact that the property passes outright or in trust for the Surviving Spouse, and qualifies for the Unlimited Marital Deduction previously discussed. As such, this QTIP property does not trigger an immediate Death Tax for the Deceased Spouse's estate, but instead any Death Tax is deferred until the death of the Surviving Spouse, at which point the QTIP property is included as part of the Surviving Spouse's Death Tax Estate. If the Surviving Spouse then has a total that is less than the Death Tax AEA at the time of death, no Death Tax would be owed.

"Terminable Interest" refers to the fact that the interest of the Surviving Spouse is only for the lifetime of the Surviving Spouse, and there is no interest of the Surviving Spouse that is passed on at the death of the Surviving Spouse. The Deceased Spouse's property held in a QTIP Trust will be passed to those heirs or other beneficiaries that the Deceased Spouse had already designated, with the Surviving Spouse not being able to change that distribution.

The Clayton Election has the major benefit that it provides the same asset protection for the Deceased Spouse's property that either goes into a Bypass Trust or a different trust for the benefit of the Surviving Spouse. This is the same asset protection as the mandatory division of the property of the married couple that is found in the typical A-B Marital Trust. However, because of the ability for the Personal Representative of the Deceased Spouse to make the election, there is some planning flexibility using this approach, where there is no planning flexibility if the division is required as is the case with the typical A-B Marital Trust discussed above.

How Inheritances Are Lost - Planning for Your Children's Inheritance

Traditional estate planning in the past focused on avoiding Probate and Conservatorship, and minimizing or eliminating the Death Tax. However, little or no attention was paid to planning for the safe passage of assets on to the next and subsequent generations of heirs without them being lost through a number of reasons.

There is a proverb from Asia that roughly translates as, "from rice paddy to rice paddy in three generations." In general, what this means is that the first generation of a family, many times poorly educated but hard working and driven by strong cultural values, often has built a family fortune to pass on to the next generation.

Here in Santa Clara County (the "Silicon Valley") where I practice law, this can be seen in the many family businesses and fortunes that have been built by the first members of a family to move into the valley, often from other parts of the country or the world. Orchards, farms, restaurants, department stores, wineries, convenience and grocery stores, and many other businesses fit this pattern. It can also be seen in the many success stories of immigrants and others achieving financial success in the tech industry.

The second generation here in the Silicon Valley is often better educated, with the education paid for from the family fortune built by the first generation. This generation may still have many of the values of the first generation, and may also have an interest in continuing the family business, building further wealth.

The third generation, however, is often still better educated than the previous generation, and has likely been raised entirely in the new culture. This generation often has no interest at all in the family business, which can lead to the family business and wealth being lost due to lack of interest. Even if the third generation is interested, there are several forces conspiring together to destroy the wealth of the family.

Through a series of stories in this section, I will discuss the various ways that families and their heirs lose inheritances. Finally, I will discuss how, with proper planning, a family can work together to guarantee, as much as possible, that the family wealth will not be lost.

Bill's Story

Bill had been in financial difficulty his whole life. He had maxed out his credit cards, was late on his rent, and already had several judgments against him for unpaid bills. His wages at work were being garnished by various creditors. At age 30, his prospects were bleak.

Then Bill's parents died, leaving him everything they owned, including their house. Unfortunately, their property was left outright to Bill. Bill's creditors took all of the cash, and soon, because Bill had never learned how to handle his finances, he lost the house to foreclosure as well. Forty years of hard work and sacrifice by his parents was gone in less than two years, at the end of which Bill was still in debt, and had nothing left from his parents. If only someone had been able to take care of Bill's inheritance for him.

Ruth's Story

When Ruth's parents died, they left her a nice inheritance. Unfortunately, four years later, Ruth was in a car accident that incapacitated her, leaving her in a wheelchair. Ruth now needed 24-hour care due to her injuries. Because Ruth had property, she was forced to use all of her property to pay for her care, <u>including her inheritance from her parents</u>. As a result, not only was her property lost paying for her care, but her inheritance from her parents was lost as well. Ruth is now trying to survive solely on government assistance. She hopes that the government will be there in the future for her, but she is uncertain.

Marisa's Story

Marisa had been happily married to Jim for ten years, and had two wonderful children. Two years ago, Marisa's mother Jane died, leaving her home and investments totaling over $800,000. The house was sold and the investments were liquidated, converting everything into cash. When the check arrived from her mother's lawyer for her inheritance, Marisa put the check into the joint account she held with her husband. Five years later, Marisa died, and everything they owned together, <u>including Marisa's inheritance</u>, went to Jim. Jim then remarried, started a new family, and left everything to his new wife and new child, with nothing going to Marisa's children. If only her mother had left Marisa's inheritance in another way.

John's Story

John had started his furniture store with high hopes. He had sunk everything he owned into the fixtures, inventory, lease, etc. So, when he ran out of money and his business failed, all of his vendors and other creditors came after him for payment. He was forced to file for personal bankruptcy, facing the fact that he was going to lose almost everything he owned. Unfortunately, his troubles were just beginning. To add insult to injury, one month after he filed for bankruptcy, his father died, leaving him an inheritance of $500,000. Because he was in bankruptcy at the time, the court-appointed bankruptcy trustee seized his inheritance, and used it to pay John's creditors. When the bankruptcy trustee was done, John was out of bankruptcy, but there was only $50,000 of his inheritance left. The rest had gone to his creditors. Could something have been done differently by John's father?

Janet's Story

Janet's parents died, leaving her about $500,000 that she promptly invested in a diversified portfolio of stock, bonds, and mutual funds. A few years later, Janet was out driving near the farmer's market at her local mall when she lost control of her car and drove right through a crowd of people waiting in line for kettle corn.

Although nobody was killed and it was ruled an accident by the police, Janet ended up seriously injuring 10 people. The resulting lawsuits against her for negligence ended up in judgments against her that were more than her automobile and homeowners' insurance. The resulting collection efforts by her judgment creditors took nearly everything that Janet owned, including the $500,000 inherited from her parents. Could the accidental loss of Janet's inheritance have been avoided?

Mike's Story

Mike lost his parents when he was 16 years old. He went to live with his aunt and uncle, who were also given control of the property left to Mike by his parents, which totaled over $300,000.

Unfortunately, when Mike turned 18 years of age, he demanded his inheritance from his aunt and uncle, who were obligated by law to turn the $300,000 over to Mike. Because Mike had no experience handling money, he spent his inheritance like there was no tomorrow. He dropped out of high school, bought a sports car, partied with his friends, and managed to run through his entire inheritance within a couple of years.

Instead of using the money to finish high school and go on to college or to start a business, at the end of two years, Mike had no money left, and he was reduced to working at a minimum wage job just to put food on the table. If only someone else could have handled his inheritance for him until he was educated and knew more about money.

The Common Thread

All of the children in the stories related above shared the following in common – they all lost their inheritances because they received their inheritance outright from their parents.

Is there an alternative that can protect a child's inheritance from being lost in one of these ways?

Yes. I call it the **"Castle Trust Planning Option."**

The Castle Trust Planning Option: Protecting An Inheritance

The Castle Trust Planning Option protects your children's or other heir's inheritance by passing the inheritance in trust instead of outright to them. It can be appropriate whether you are married or unmarried. The Castle Trust Planning Option has the following benefits:

- ✓ Your children or other heirs have the use and benefit of the property held in trust, and the Trustee of the trust may use as much of the income and other property in the trust that is necessary for their needs in the areas of health, education, maintenance and support;
- ✓ Your children or other heirs do not actually own the property – it is owned by the trust, which is an irrevocable trust;
- ✓ The lack of ownership of the inheritance by your children or other heirs provides a high level of asset protection for their inheritance. Because the inheritance is not owned, it is almost impossible for the beneficiaries to lose it in a divorce, a lawsuit, bankruptcy, or through mismanagement;
- ✓ When properly structured, this planning option can also pass on the children's or other heirs' inheritance to their own children or other heirs, with the same asset protection as before; and
- ✓ Finally, property passed on in this way using your Death Tax AEA can then be passed on to your children's or other heir's descendants for possibly several generations free from the Death Tax! Imagine being able to pass on several hundred thousand dollars that can grow for several years without being touched by the Death Tax system. This is one of the major benefits of the Castle Trust Planning Option. The Castle Trust Planning Option is the sensible alternative to leaving an inheritance outright to a child or other heir.

The Children's Legacy Plan: Planning for Your Minor Children's Care

If you are a parent with minor children (i.e. under the age of 18 years), then there is an important question you need to ask yourself:

If you went out to dinner tonight and didn't come home, what would happen to your children?

It's a hard question, but the reality is that, without proper planning, your children could end up in the county "foster care" system.

Even police and social workers who work in the foster care system will admit that it is overcrowded, underfunded, and "broken." Most of them will work as hard as possible to avoid taking your children into custody and putting them into foster care. However, in order for them to do that, they need to be assured that your children will not be at risk if they are left in the care and custody of other adults until the Probate Court can appoint one or more guardians for your children.

Your children could end up with relatives you would want to raise them, or could end up with relatives you would not want to raise them. Or, with proper planning, they could end up with friends that share your values and beliefs.

The Children's Legacy Plan:

1. Helps to keep your minor children out of foster care if something happens to you;
2. Provides for Temporary Caretakers or "First Responders" that can temporarily take custody of and care for your minor children until Permanent Guardians can be appointed by the Probate Court;
3. Nominates Permanent Guardians for your children to give the Probate Court guidance on your wishes;
4. Confidentially identifies those family members that you want not want to serve a guardians for your children. This can be for whatever reasons (e.g., emotional, physical or sexual abuse, drug or alcohol problems, poor financial habits, history of mental illness, history of criminal behavior, etc.)
5. Provides a medical power-of-attorney for each of your minor children so that someone you trust can make medical and health care decisions for them if you are not available or unable to do so;
6. Provides written instructions for each of your children's caregivers such as their daycare, pre-school, elementary or high school, etc., so that they know who to call and what to do if they find out that something has happened to you;
7. Provides written instructions and guidance for the guardians of your children, letting them know how you wish for your children to be raised, what activities you want them to be involved in, and who the people are in their lives that you wish to continue in their lives, including any restrictions on contact with those people;

The Children's Legacy Plan provides for all of these contingencies, at an affordable cost that will provide "peace of mind" for you and your children.

The Children's Legacy Plan is especially important to consider if your family lives in other states or even other countries. It helps to have one or more local friends who could temporarily care for your children until family can arrive to start the Guardianship process in the Probate Court. This can keep your children out of the foster care system.

Hire an Experienced Estate Planning Attorney

By this time, hopefully you have concluded that estate planning is not something that you try to do yourself. Trying to do your own estate planning is like trying to operate on yourself if you need surgery, or trying to fix the problems with your modern car engine with all of its computerized functions --- you will likely end up with a worse problem than when you started, and may have been better off doing nothing at all!

Estate planning is both an art and a science. To do it well involves hundreds of hours of study, and hundreds of hours of continuing education every year. There is no such thing as a "simple" estate, despite what the "Legalzooms" or "Suzie Ormans" of the world may imply. Proper estate planning requires an experienced practitioner who can not only answer your questions, but also knows what questions need to be asked.

My Estate Planning Process

My planning process is done in three steps, as follows;

Step One - Initial Consultation

At this meeting we discuss your desires, concerns and goals for your family. We also discuss appropriate tax avoidance strategies, disability planning, and the various levels of estate planning as well as the fees and costs involved in their implementation.

To provide me with the information I need to properly advise you about your estate planning, including probate and estate tax issues, I have you complete a few worksheets to bring with you to the Initial Consultation. If you are married or in a registered domestic partnership, or if you are unmarried and you and your partner wish to coordinate your planning, an additional consent form will need to be signed before the consultation can be commenced.

I ask that you bring any existing wills, trusts or other estate planning documents and a current photo of you and your family members that I can scan and copy for your file. I also ask that you bring originals or copies of recent statements for all bank, brokerage and retirement accounts, along with any life insurance policy statements, LLC or Partnership Agreements and, if available, the deeds and current property tax statements for any real estate that you own. Having this information available will make your Initial Consultation more valuable, because I can better advise you of your planning options. Without this information, my ability to advise you will be severely limited.

Engagement Letter: At the end of the Initial Consultation, should you decide to engage me to prepare your estate plan, you will execute an Engagement Letter with me and will be provided with a homework binder to complete and bring with you to your Plan Design Meeting. I can also provide the paperwork in an electronic form that can be completed as Microsoft Word "forms."

I will also take a deposit from you at that time which will be one-half of the anticipated flat fees for the preparation of your estate plan. The Plan Design Meeting is generally scheduled for a date about two weeks after your Initial Consultation, but you also have the option of scheduling it through my online calendaring system when you are ready to proceed.

Step Two - Plan Design Meeting

At your Plan Design Meeting we will go over your homework binder, confirming your choices and answering your new questions that came up as you went through your binder. In this meeting, I work like an architect, creating a "blueprint" for your estate plan that reflects your wishes and desires. It is expected that all planning decisions will be confirmed or made in this Plan Design Meeting.

Decisions will be made in the Plan Design Meeting about the following:

1. Who will be guardians for minor children;

2. Who will be Successor Trustees for your living trust and Financial Agents to handle other financial matters under your general durable power of attorney;
3. Who will be your Health Care Agents to make medical and health care decisions for you if you become incapacitated;
4. How your property is to be held and distributed to care for you while you alive, and how it is to be distributed after your death;
5. Any special distribution instructions for your property, such as an outright distribution, structured distribution, special needs distribution, or Castle Trust Planning Option; etc.

Step Three - Signing Appointment

I firmly believe that having 95% or more of an estate plan in place as soon as possible is better than a 100% perfect estate plan that never gets signed and implemented!

After completion of the Plan Design Meeting, a Signing Appointment will then be scheduled one to two weeks after the Plan Design Meeting, where you will come in to sign your estate plan. The balance of the fee and any costs will be due at this time.

You will then have 60 days from the date of signing to have anything that you wish to change be corrected in your plan, such as misspelled names or changing the order of successor trustees or other people you have named to care of you and/or your property.

Overview of Legal Services and Fees

Foundational estate planning refers to the preparation of wills, living trusts, advance health care directives, powers-of-attorney, and other supporting estate planning documents designed to address the estate planning needs of the majority of my clients. All of my living trust plans contain foundational estate planning documents. It may also include special planning for those with minor children.

Some clients may need advanced estate planning using additional planning tools such as the ILIT (Irrevocable Life Insurance Trust), the CRT (Charitable Remainder Trust), the IRA Inheritance Trust, or SNT (Supplemental Needs Trust) for special needs persons. Those planning tools are discussed in later sections of this brochure.

My fees for legal services are generally flat fees, and determined by the amount and level of planning desired. I could legitimately charge at least double what I do charge due to my expertise and the quality of my planning. However, I have intentionally kept my fees affordable in order to assist more families with their planning needs.

My current fee schedule for foundational and advanced estate planning services as of **June 1, 2011** can be found on the next page. A description of the various levels of planning and what is included in the fees immediately follows. Fees for my legal services are subject to change without notice.

Fee Discounts: Members of various legal plans offered through employers such as ARAG, CLC Incorporated, Caldwell, and Lawpoint (LegalConnect) may qualify for discounts of around 25% off my legal fees. Check with your human resources department to see if you qualify. Many companies have an Employee Assistance Plan that has a legal service plan component. If you qualify, request a referral to me through your legal plan.

Members of AARP, AMAC, Gemini Crickets (Parents of Multiples) and Las Madres Neighborhood Playgroups, as well as attendees to my living trust seminars will qualify for discounts of 20% off my legal fees.

Legal fee discounts are not cumulative, and only the best discount available will be applied.

Current Fee Schedule as of June 1, 2011
(subject to change without notice)

PLANNING OPTION	***INDIVIDUAL****	***MARRIED COUPLE***
Living Trust Plan	**$2,500.00**	**$3,000.00**
Children's Legacy Plan	**$500.00**	**$500.00**
Charitable Remainder Trust	**$2,000.00**	**$2,000.00**
Irrevocable Life Insurance Trust	**$2,000.00**	**$2,000.00**
Supplemental/Special Needs Trust	**$2,000.00**	**$2,000.00**
IRA Inheritance Trust	**$3,000.00**	**$3,000.00**

* "Individual" includes an unmarried person, a married person who wishes to do planning for separate property assets in a marriage, and each life partner in a registered domestic partnership or other unmarried partnership, including married gay & lesbian couples.

NOTE: Planning for California Registered Domestic Partners, same sex couples who were legally married in 2008, and unmarried couples who wish to coordinate their estate planning. Because there is no practical way to create a <u>joint</u> living trust estate plan in these situations, planning consists of <u>two</u> coordinated individual estate plans. Even though the State of California has extended many of the protections of inheritance, child care and custody, and other rights for registered domestic partners and married gay and lesbian couples, the federal government does not recognize domestic partnerships for federal tax planning. Because of this, <u>effective</u> tax and other planning for registered domestic partners requires the preparation of separate plans for each partner.

<u>**NOTE REGARDING ESTATE PLANNING FOR RETIREMENT PLAN ASSETS:**</u> The designation of beneficiaries on retirement plans such as IRA accounts, 401(k), 403(b) and similar plans has significant income and estate tax implications. The IRA Inheritance Trust is designed to deal with these assets. There is a single fee for individuals, married couples, and registered domestic partners. Married couples and registered domestic partners will receive two identical IRA Inheritance Trusts for the $3,000 fee. If there are substantial differences between the planning contemplated by any couple, an additional $500.00 fee will apply at my option.

<u>Additional Fees and Costs for Foundational Estate Plans</u>:

All of my fees for foundational estate planning are flat fees, and there are generally no additional fees with the following exceptions:

1. Each California real estate deed transfer is currently $225.00 each (subject to change without notice), which includes notarization and recording fees;
2. Out-of-state real estate transfers are done at cost, using outside providers such as attorneys and title companies; and
3. Additional consultation appointments or Plan Design Meetings after the first one will be billed at the current rate of $350.00 per hour, with a minimum of one hour billed regardless of actual time spent.

Available Estate Planning Options

Planning for the orderly distribution of the family's wealth is complicated. I offer several different levels of planning designed to serve the needs of a wide range of families. As such, the level of customization for planning will be different depending on the level of planning selected.

Foundational estate planning involves the preparation of a revocable living trust with several additional legal documents such as special Wills called "Pour-over Wills, Advance Health Care Directives, and Durable Powers-of-Attorney. Foundational estate planning is designed to avoid Conservatorship, avoid Probate, and provide for the orderly distribution of family wealth from one generation to the next. Foundational estate planning may also include tax planning for the Federal Estate Tax and asset protecting planning for the inheritance to be passed to a spouse, partner, children or other heirs.

Advanced estate planning techniques are designed to do things such as provide for income tax and estate tax free inheritance for heirs, provide asset protection for retirement plans passed on to the next generation, and special planning for special needs children and adults.

All foundational and advanced estate plans are prepared personally by me based on your wishes and concerns. I do not use document preparation services or other staff.

Note: The designation of beneficiaries on retirement plans such as IRA accounts, 401(k), 403(b) and similar plans has significant income and estate tax implications. The advance planning technique of the IRA Inheritance Trust (see below) is designed to deal with these assets which cannot be adequately dealt with by foundational estate planning options.

The Living Trust Plan

The Living Trust Plan is designed to accomplish some or all of the following goals:

1. Avoid Conservatorship while you are alive through the use of comprehensive custom drafted legal documents such as the Living Trust Agreement, General Durable Power of Attorney, and Advance Health Care Directive;
2. Avoid Probate at your death through the use of the Living Trust Agreement and your Pour-Over Will);
3. Provide asset protection planning for any inheritance received by a surviving spouse or partner through the Living Trust Agreement;
4. Provide asset protection planning for any inheritance received by children or other heirs through the Living Trust Agreement;
5. Pass on property protected from the federal estate tax for two or more generations through the Living Trust Agreement;
6. If married, can permit planning to minimize or eliminate the impact of the federal estate tax through the Living Trust Agreement;
7. Plan for many different family situations through the Living Trust Agreement, such as the following:
   - ✓ Second marriage

- ✓ Substantial separate property assets in a marriage
- ✓ Children from a prior marriage or relationship
- ✓ Special needs children or other beneficiaries
- ✓ Non-citizen spouses, beneficiaries or proposed trustees
- ✓ Guardians for minor children

ASSET PROTECTION PLANNING: Providing asset protection planning for a surviving spouse, partner, children or other heirs can be especially important if a person has any of the following problems or issues:

- Heir is too young or financially immature
- Heir has a drug, alcohol or gambling abuse problem
- Heir is in a bad marriage
- Heir has lawsuits or judgments against them, or is in bankruptcy
- Heir is a special needs person, relying on government assistance for shelter, income, custodial medical care, or medical insurance
- Heir dies without doing estate planning
- Heir goes through a divorce without planning for their received inheritance
- Heir is in a high risk profession or occupation such as law, medicine, accountancy, etc.

Living Trust planning is completed in <u>three</u> (3) steps:

1. An Initial Consultation of 1-2 hours, where the decision is made to engage my services to prepare a Living Trust Plan. If my services are engaged, then paperwork is provided for completion prior to the next meeting;
2. A Plan Design Meeting of 1-2 hours, where the paperwork provided in the Initial Consultation is reviewed and discussed, ending with a complete design for the Living Trust Plan that reflects your wishes and desires; then
3. A Signing Appointment of 1.5 to 2 hours, where all of the Living Trust Plan paperwork has been prepared and is ready for signing. A final review is made of the choices made in the Plan Design Meeting, any last minute adjustments are made, and then the legal documents are signed, notarized and/or witnesses as needed.

After signing, you will have a time period of 60 days to read over all of the paperwork and come back with corrections of typographical errors or other minor modifications to the documents that you wish to make with no additional fee. A major change such as a change in the distribution plan of the Living Trust Plan <u>will</u> incur an additional flat fee.

What is Included in Your Living Trust Plan

DOCUMENTS AND PLANNING OPTIONS	INCLUDED IN PLAN?
Custom Drafted Living Trust Agreement	**Yes**
Estate tax planning	**Yes (married couples)**
Planning for a non-citizen spouse	**Yes**
Planning for a special needs person	**Yes**
Asset protection planning for surviving spouse or partner	**Yes**
Castle Trust Planning (Asset protection) for children or other heirs	**Yes**
Nominating guardians for your minor children for each client	**Yes**
Pour-Over Will for each client	**Yes**
Custom Drafted Durable Power of Attorney for each client	**Yes**
Custom Drafted Advance Health Care Directive for each client	**Yes**
HIPAA Authorization for each client	**Yes**
Assignment of Personal Property for each client	**Yes**
Certification of Trust	**Yes**
Personal Property Memorandum	**Yes**
Documents to self-maintain some parts of Living Trust Plan	**Yes**
Free plan review every 3 years	**Yes**

The Children's Legacy Plan Revisited

As noted previously in this brochure, the Children's Legacy Plan can assure as much as possible that your minor children will never spend a minute in foster care. You will provide detailed instructions regarding every phase of your children's lives to the people that will be caring for your children. Using a unique combination of legal and non-legal documents, you can provide for the short-term, temporary care of your children if you become incapacitated or die, as well as provide for the long-term care of your children until they reach adulthood.

DOCUMENTS AND PLANNING OPTIONS	INCLUDED IN PLAN?
Nomination of Temporary Caretakers	**Yes**
Nomination of Permanent Guardians	**Yes**
Confidential Exclusion of Guardians	**Yes**
Instructions to Caretakers	**Yes**
Instructions to Guardians	**Yes**
Medical Power of Attorney for Minor Children	**Yes**

The Nomination of Temporary Caretakers identifies those persons that you are confident could temporarily care for your minor children until court action has been taken to appoint a temporary and/or permanent Guardian for your children.

The Nomination of Permanent Guardians identifies those persons that you are requesting be appointed by the Court to actually care for and raise your children.

The Confidential Exclusion of Guardians identifies those persons that you would not want to be appointed at any time by the Court as Guardians for your children, because it contains specific reasons why these persons are to be excluded.

The **Instructions to Caretakers** and **Instructions to Guardians** are forms provided as part of the plan for you to complete and give to those people who are caring for your children (e.g. day care, preschool, school, babysitters, etc.), and a format to give instructions to your proposed Guardians on how you wish for your children to be raised.

The **Medical Power of Attorney** grants authority to persons to make medical and health care decisions for your children if you are unavailable to make those decisions yourself. It is not a substitute for a permanent guardianship, but can handle temporary situations and also that time period covered by the Nomination of Temporary Caretakers described above.

The Charitable Remainder Trust

Ask yourself the following questions:

- ✓ Do you own a highly-appreciated asset such as a rental property or stock portfolio?
- ✓ Does that asset not generate as much income as you would like?
- ✓ Would you like to be able to sell that asset and reinvest the proceeds without triggering any capital gains tax?
- ✓ Would you like to create a stream of income from the new investments for several years, or even for the rest of your life?
- ✓ Would you like to reduce your estate taxes as well when you make the sale of this highly-appreciated asset?
- ✓ Would you like to benefit charity and receive a charitable income tax deduction as well?

If you can answer "yes" to one or more of the questions above, then a Charitable Remainder Trust ("CRT") may be of benefit to you.

The CRT is a special type of irrevocable (i.e. unchangeable) trust can accomplish all of the goals contemplated by the questions above. Essentially what happens is this:

1. A CRT is created by the owner of the highly-appreciated asset;
2. The CRT provides for income to the owner of the highly-appreciated asset either for a period of years (up to 20), or for life, making the owner the "income beneficiary;"
3. One or more charities (known as the "remainder beneficiaries") are designated to receive the property remaining in the CRT after the death of the income beneficiary or the expiration of the time period designated in the CRT;
4. The highly-appreciated asset, such as a rental property, is transferred to the ownership of the CRT by the original owner;
5. The Trustee (i.e. person in charge) of the CRT then sells the asset, and, because the CRT has one or more charities as the remainder beneficiaries, there is no taxable capital gain due to the sale;

6. The Trustee then reinvests <u>all</u> of the proceeds from the sale, and pays an annual income to the income beneficiary either for a period of years or life, depending on what the CRT says;
7. The income beneficiary/original owner will receive an <u>immediate charitable deduction</u> for income tax purposes, which is the <u>present value</u> of the future gift that the charities will receive on the death of the owner or expiration date of the CRT. The amount of the deduction is based on the amount of income payout from the CRT, and whether the payout is for a term of years or the life expectancy of the income beneficiary, and can be taken against up to 50% of adjusted gross income;
8. At the death of the income beneficiary (or upon expiration of the term of years), the charities receive whatever is left in the CRT; and
9. The value of the asset in the CRT, including any appreciation over time, is not part of the estate of the original owner of the asset, reducing the taxable estate for Death Tax purposes.

The CRAT (Charitable Remainder Annuity Trust)

- ✓ Donor makes a one-time gift of property to irrevocable trust with a charitable organization as beneficiary;
- ✓ Donor receives a specific annual distribution equal to at least 5% of the *initial net market value* of the CRAT assets; and
- ✓ Donor receives the annual distribution for a period of time, either for lifetime or a fixed period not exceeding 20 years, with the remainder of the trust paid to the charity on the Donor's death.

The CRUT (Charitable Remainder Unitrust)

- ✓ Donor makes a gift of property to irrevocable trust with a charitable organization as beneficiary. Multiple gifts can be found to the same CRUT;
- ✓ Donor receives an annual fixed percentage distribution equal to at least 5% of the *yearly net market value* of the trust assets; and
- ✓ Donor receives the annual distribution for a period of time, either for lifetime or a fixed period not exceeding 20 years, with the remainder of the trust paid to the charity on the Donor's death.

The NIMCRUT (Net Income CRUT with "make up" provisions)

- ✓ Donor makes one or more gifts of property to irrevocable trust with a charitable organization as beneficiary. Multiple gifts can be made to the same NIMCRUT;
- ✓ Donor receives income from the NIMCRUT <u>up to</u> an annual fixed percentage equal to at least 5% of the *yearly net market value* of the trust assets. If trust income is not sufficient to pay out the full fixed percentage in any year, the trust may "make up" the deficiency in future years when the trust income is higher; and
- ✓ Donor receives the annual distribution for a period of time, either for lifetime or a fixed period not exceeding 20 years, with the remainder of the trust paid to the charity on the Donor's death.

IMPORTANT NOTE: Using a CRT can be extremely powerful if the Donor is also insurable. Because of the charitable deduction available to the Donor for the gift to the CRT, a useful strategy is to use some of the income from the CRT and/or the income tax savings due to the charitable deduction to pay the premiums for a life insurance policy held in an Irrevocable Life Insurance Trust, or "ILIT" (see below) The life insurance can be passed on income and estate tax free to the Donor's heirs, and can be used to replace the value of the property transferred to the CRT.

The "Wealth Preservation Trust" or "ILIT" (Irrevocable Life Insurance Trust)

Life insurance owned by you when you die is part of your taxable estate for Death Tax purposes. This means that a large insurance policy you own could end up creating a Death Tax problem for you. For example, if you have an estate of $1,000,000 while alive, with a $1,000,000 life insurance policy that pays on your death, your estate will be valued at $2,000,000 after death, which is $1,000,000 more than the $1,000,000 Death Tax exemption that will apply again in 2013. The $1,000,000 would be taxed at tax rates from 41% to 55%, costing your family hundreds of thousands of dollars, all coming out of the life insurance proceeds.

However, if the life insurance was properly transferred to an Irrevocable Life Insurance Trust, or "ILIT" prior to your death, the entire $1,000,000 would be removed from your Death Tax estate! This would save hundreds of thousands of dollars for your family.

An ILIT generally has the following characteristics:

- ✓ Established to own one or more policies of life insurance on the life of the Trustor/Grantor (i.e., the person who created the ILIT), with the ILIT as the beneficiary of the life insurance;
- ✓ Cash gifts are made by the Grantor to the Trustee of the ILIT (who is not the Grantor). Gifts that are under the annual gift tax exclusion (i.e., currently $13,000 per person per year) are not taxable to the Grantor, and also reduce the Grantor's taxable estate for Death Tax purposes;
- ✓ If properly drafted, funded, and administered by the Grantor and the Trustee over the years, life insurance proceeds will be paid to or for the benefit of the heirs free from state and federal income tax, and free from inheritance taxes in those states that have them and the federal estate tax (the "Death Tax"); and
- ✓ When the insurance proceeds are paid to the Trustee of the ILIT, they can be used to loan money to the estate of the Grantor, or purchase assets of the Grantor's estate to provide for immediate cash that may be needed to pay creditors, funeral expenses, income taxes, inheritance taxes or Death Taxes.

ILITS can be used to accomplish the following:

- ✓ To provide for liquidity in a decedent's estate, especially where the estate has many illiquid assets such as real estate, a family business, or a stock, bond or mutual fund portfolio that the heirs do not wish to be forced to sell;
- ✓ In a second marriage situation, to provide a fund to pay an inheritance to the Deceased Spouse's children while leaving other property directly to or for the benefit of the Surviving Spouse. This can avoid long-term animosity or conflict between the Deceased Spouse's children who are the stepchildren of the Surviving Spouse, and can also assure that the Deceased Spouse's children are not accidently or inadvertently disinherited by their stepparent (the Surviving Spouse);
- ✓ To remove life insurance death benefits from the taxable estate of the owner of the life insurance policy when the insured person dies, providing estate tax savings up to 55% of the value of the life insurance in taxes that are no longer owed and do not have to be paid; and
- ✓ To provide an inheritance for a spouse, partner and/or children that has the asset protection benefits of the **Castle Trust Planning Option** discussed above.

IMPORTANT NOTE: The ILIT works especially well when used together with a Charitable Remainder Trust, described above. Cash flow from the CRT can be used to make gifts to the ILIT that are used to pay the premiums on the life insurance. The charitable deduction that is available with the CRT means that potentially some or all of the gifts made to the ILIT are actually made

with "free" dollars, because the charitable deduction may completely offset the income coming out of the ILIT for several years.

The Supplemental Needs Trust for Special Needs Children and Others

Children and others who are disabled are especially vulnerable, and special planning needs to be pursued for them because of their special needs. A Supplemental Needs Trust (SNT) is intended to make provision for a special needs person without jeopardizing their government benefits now or in the future, and to "supplement" those benefits to provide a higher level of care and quality of life that the government cannot provide.

This brochure does not cover the particulars of SNT planning, but below is a brief list of costly mistakes that parents can make when planning for their special needs child or other person. A more detailed article describing these mistakes (and others) in more detail, along with solutions, can be obtained by called my office at (408) 247-0444 or visiting www.lawbob.com or www.lawbob.net where the article can be downloaded at no charge.

MISTAKE #1: Disinheriting the child.

MISTAKE #2: Procrastination.

MISTAKE #3: Failure to coordinate a planning team effort.

MISTAKE #4: Ignoring the child's specific special needs when planning for the child's benefit.

MISTAKE #5: Creating a "generic" special needs trust that doesn't fit the child.

MISTAKE #6: Failure to properly "fund" and maintain the plan.

MISTAKE #7: Choosing the wrong trustee.

MISTAKE #8: Failing to invite contributions from others to the trust.

MISTAKE #9: Relying on siblings of your special needs child to use their money for your special needs child's benefit.

MISTAKE #10: Failing to protect the special needs child from predators.

A separate Supplemental Needs Trust should be considered for your child with special needs. It can be funded while you are still alive, can accept contributions from family members and friends, and can be the beneficiary of your estate, proceeds from life insurance distributed from an ILIT, or even the beneficiary of a retirement plan (if planned inside an IRA Retirement Trust).

The IRA Inheritance Trust: Estate Planning for Retirement Plan Assets

Important Note Regarding Special Estate Planning for Retirement Plan Assets: Making the proper beneficiary designations for retirement plans involves many complex tax and individual family issues. The designation of beneficiaries on retirement assets such as IRAs, 401k plans, 403b plans, 457 plans, and pension plans has many serious legal and tax implications.

Generally, estate plans that only use a revocable living trust to transfer assets do not specifically address the complicated issues involving retirement plans. Under current law, however, the distribution out of retirement plans after your death can be extended or "stretched" for several years, potentially preserving more of the retirement plan assets for your heirs. Simply designating your revocable living trust as the primary or secondary beneficiary of such retirement plans will often result in the loss of significant tax benefits in the future, and will often require that such plans be distributed out in as little as five years.

With proper planning, a retirement plan can be passed on to children or other heirs in an asset-protected form such as the **Castle Trust Planning Option** described above. With the power of tax-free, compounded growth for the retirement plan assets, even a modest retirement plan of $150,000 to $200,000 could be worth millions of dollars to your heirs over time, in a form of ownership known as an "inherited IRA."

To provide the asset protection of the **Castle Trust Planning Option**, and the tax-free growth of an inherited IRA, I provide an estate planning trust called the **"IRA Inheritance Trust."** The **IRA Inheritance Trust** assures as much as legally possible that a child's inherited IRA will not be subject to creditors' claims, bankruptcy, or loss due to death or divorce.

The **IRA Inheritance Trust** is a complex, advanced estate planning tool. Because of its complexity and the tremendous financial and asset protection benefits of this planning for retirement plan assets, my fees are higher for this additional planning.

IRA Inheritance Trust planning includes the following:

1. A completely-customized **IRA Inheritance Trust** for you and your spouse or partner;
2. Specially drafted Beneficiary Designation letters;
3. An "Owner's Manual" for the IRA Inheritance Trust, that includes the following:
   a. An IRA Inheritance Trust Flow Chart;
   b. Certification of Trust;
   c. Operating Procedures Checklist;
   d. Personal Directions;
   e. A Statement Organizer, and
   f. A Review Checklist.
4. Asset protection for your heirs' inheritance;
5. A free in-office review of your IRA Inheritance Trust every three years; and
6. A free consultation for your successor trustee after your death.

If you wish to obtain more detailed information about the **IRA Inheritance Trust**, I urge you to attend one of my public seminars, which will also entitle you to receive a discount off my usual fees. Conditions do apply to receive the discount. Visit my website at www.lawbob.com for information about upcoming **IRA Inheritance Trust** seminars.

Public and Private Living Trust Seminars

As part of my ongoing effort to educate and inspire the public to take action and do comprehensive estate planning for their families, I offer regular free seminars and workshops for the general public, companies, nonprofits and government agencies. I also offer free seminars for churches, parents' groups, civic organizations, and even extended families who wish to find out more about planning for their family's future.

Public Seminars: To attend a public seminar on living trusts, please visit my website at www.lawbob.com, where you can see the dates and times of upcoming seminars, and also make a reservation through the website.

Living Trust seminars are generally held on the second and fourth Saturdays each month from 9:30am to 11:00am at the Law Offices of Robert P Bergman, 1777 Saratoga Avenue, Suite 210, San Jose, CA 95129 (on Saratoga Avenue between Williams Road and Moorpark Avenue, approximately 1.25 miles south of

Interstate Highway 280). Other seminars on advanced planning options such as the ILIT, the CRT, and the IRA Inheritance Trust may be added from time to time. Check my website at www.lawbob.com for details and to register.

Private Seminars: I am also available to come to your company, parents' group, preschool, school, daycare center, church, synagogue, association, or community group to give a private living trust seminar. Just call my office at (408) 247-0444, or email to rpb@lawbob.com, and I will get back to you to schedule your private estate planning seminar. I provide all of the handout materials and equipment (laptop, projector and screen), and you provide the location.

Information Website – www.lawbob.net

Besides my main website at www.lawbob.com, I also maintain an information website at www.lawbob.net. This information website contains articles and an online version of my living trust seminar that can be viewed online or downloaded for later viewing. I add new articles regularly to this website, so you should bookmark it in your web browser.

Living Trust Seminar Website – www.freelivingtrustseminar.com

I also have a website where you can also view my living trust seminar that can be viewed online or downloaded for later viewing.

Schedule Your Consultation Today

Scheduling your Initial Consultation with the Law Offices of Robert P. Bergman is as easy as picking up your telephone and calling (408) 247-0444, OR visiting www.lawbob.com and clicking on the link near the top of the home page, on the left side of the home page to "Request a Consultation," or by clicking on any link to "Schedule an Estate Planning Consultation." Appointment times are generally available from Tuesdays through Saturdays, and I try to accommodate your needs as much as my schedule permits.

Consultations are also available on a limited basis in homes, hospitals, or care facilities. However, due to the increased time and expense of providing estate planning services in such circumstances, including the necessity for multiple trips, initial consultations will be billed at the rate of $350.00 per hour of consultation time, and $150.00 per hour for travel time to and from our office to the location, with no credit against the cost of any estate plan that we are engaged to prepare for you. Additionally, flat fees for estate plans may be charged up to a 100% premium depending on how quickly the estate plan needs to be prepared.

I hope this brochure has been useful for you, and that you are encouraged to take action today to have your estate plan prepared. Thank you for your interest.

Please use the pages below to take any notes or any questions you may wish to have answered.

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About Robert P. Bergman
Estate Planning Attorney and Counselor

"Planning for Your Most Important Asset...Your Family!"

Robert P. "Bob" Bergman is an estate planning attorney and counselor who specializes in the preparation of foundational estate planning, including the use of custom-drafted wills, revocable living trusts, advance health care directives, and powers-of-attorney. He is a Certified Specialist in Estate Planning, Trust & Probate Law (California State Bar Board of Legal Specialization)

Additionally, Bob prepares more advanced estate planning tools such as life insurance trusts for asset protection and estate tax planning, charitable remainder trusts, special needs and supplemental needs trusts for special needs persons, and the IRA Inheritance Trust (designed to provide asset protection and maximum tax advantages for an inherited IRA for children or other heirs). He also prepares special legal documents for families with minor children to keep them out of the foster care system.

Bob's detailed approach to the planning process assures that his clients' wishes and desires are implemented in the estate plans that he prepares. In practice since 1981, Bob leaves nothing to chance.

"California Consumer Guide to Wills, Living Trusts and Estate Planning"

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