CALIFORNIA
GUIDE TO BASIC
ESTATE PLANNING
2014

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INTRODUCTION TO ESTATE PLANNING

1.1. Why Create a Formal Estate Plan?

Estate planning is simply the formal process of creating a written plan to structure and manage your affairs during your life and after your death. Without a formal estate plan prepared with your guidance, you have a default plan controlled by statute.

If you lose capacity during your life, a conservatorship may be necessary for your personal care and management of your assets. Planning can avoid such result. The Probate Code provides an order of priority for appointment beginning with a spouse (or registered domestic partner), adult children (equally if more than one), parents, siblings, etc. At death, your default plan is intestacy, meaning the state decides how your assets are distributed. The is especially bad if a person owns real property in more than one state. While probate is filed in the state of residency, probate jurisdiction is *in rem* and ancillary probate would be necessary in each state in which real property is owned.

1.2. Objectives of Estate Planning

(a) Lifetime Objectives.

A comprehensive estate plan should provide for the best use of an individual's assets during that individual's lifetime. When doing estate planning, clients should be advised to consult with financial advisors to anticipate and provide for such lifetime needs as a child's education, income for retirement, replacement of income in the event of disability and management of the estate in the event of incapacity. These and similar objectives can be aided by utilizing a funded revocable living trust, making gifts, properly acquiring life insurance, acquiring annuities, rearranging business interests during life, buy-sell agreements, succession planning, setting up retirement accounts, setting up custodial accounts (a minor in California cannot hold assets greater than $5,000 without a trust or custodian account), creating or contributing to 529 Plans (used for college and post graduate education – may be funding up front with five (5) years of annual exclusions), and making charitable gifts, outright or in trust.

(b) Asset Succession.

Key components of estate planning for death are avoiding probate and balancing tax efficiency with a person's desires to control and direct who benefits from your estate. Achieving these goals requires thoughtful and thorough analysis of a person's assets, potential growth, family characteristics and objectives. Only then can a plan be tailored for the owner. Examples are obtaining the marital deduction against estate tax, analyzing use of applicable exclusion amount as opposed to electing to carry over (portability) the deceased spousal unused exclusion amount (DSUEA), avoiding probate, handling business interests, and making charitable gifts.

(c) Some Key Questions.

(i) Who will control financial and personal decisions in the event of incapacity?

(ii) Who will receive the estate after death?

(iii) Who will care for minor children?

(iv) Do children have special needs or issues with drugs, gambling, etc.

(v) Should lifetime gifting be considered?

(vi) Are there liquidity issues during life and death requiring attention such as disability and life insurance?

1.3. Closing Remarks

A good estate plan should seek to maximize tax efficiency, assist in the transition of assets, including control of family businesses, and assist with management and care of a person's assets and personal affairs if there is a disability during life. There are many impediments to implementing an estate plan, one of the most common is a reluctance to accept that at some point we all will pass away, and that there is always the possibility of incapacity during life. Planning forces us to address difficult choices but, once implemented, will assist the person and his or her family during life and after death.

Tax savings is only one aspect of an estate plan. It is important not to let the "tax tail" wag the dog and always try to figure out and implement a family's goals and objectives, balancing tax issues and not letting them drive the planning.

ARTICLE TWO

DOCUMENTS AND PLAYERS

When an individual prepares or updates an estate plan he or she is faced with selecting the people who will implement the plan on his or her behalf. These people are the agents, executors, trustees, guardians, and conservators.

The basic building blocks of any estate plan are: (i) a General Durable Power of Attorney for Management of Property and Personal Affairs, (ii) an Advance Health Care Directive, (iii) Pour-Over Will and (iv) a Revocable Living Trust. An individual (known as a "principal") creates a General Durable Power of Attorney and Advance Health Care Directive and names an agent (referred to as an attorney-in-fact in a Durable Power of Attorney); the individual (known in a Will as the "testator") names an Executor to manage the estate; the individual may also name and "guardians" to care for minor children; finally, the individual (called a "Settlor", "Trustor," or "Grantor" in a trust) names a Trustee, usually the Settlor during the Settlor's lifetime, to manage the trust. Successor Trustees can be adult children, trusted advisors (accountants/attorneys/money managers) or corporate trustee (trust companies).

2.1. Powers of Attorney

(a) Durable Power of Attorney. The durable power of attorney for property management allows a person (a Principal) to name an agent (attorney-in-fact) to act on the Principal's behalf with respect to property. The power granted can be a springing power (effective on incapacity or other defined event) or effective immediately. Typically the agent has the power to buy and sell property for the principal, make gifts, bring or defend against lawsuits, and make many other decisions regarding the property of the principal. The agent will often have the power to manage the principal's businesses. Accordingly, the agent should possess sufficient business, financial and legal acumen to properly manage the principal's business and property affairs. Typically, a living trust, together with a durable power of attorney can eliminate any need for a court to appoint someone to manage the assets of an incapacitated person (a Conservatorship).

(b) Advance Health Care Directive. Formerly referred to as a power of attorney for health care, the Advance Health Care Directive allows a principal to designate an agent to make medical decisions if the principal is incapacitated. The agent is authorized to make decisions about the type of treatment the agent should receive and whether or not extraordinary life saving measures should be taken (the need for this document was highlighted in the Terri Schiavo matter). All medical decisions requiring the informed consent of the patient would be made by the agent if the principal were incapacitated. While the power of attorney for property management should be a person with some degree of business and financial acumen, the agent under an advance health care directive should be a person with close personal ties to the principal who will provide the principal with care in the manner the principal would want.

2.2. Will.

In an integrated estate plan, one with a Trust that has been funded properly during life, the Will is usually simply a "pour over" document and a backup if an asset requires probate. Probate is necessary if assets outside the Trust, for which there are no probate substitutes (such as joint tenancy, beneficiary designations, community property with rights of survivorship) exceed $150,000.

If probate is necessary, the Probate Estate will be managed by a personal representative appointed by the Probate Court. An Executor is simply a personal representative who is nominated in a Will to serve in that capacity. A person does not become an Executor unless and until a Will is offered for probate and the person nominated is appointed by the court.

The Executor's job is to act as the legal representative of a decedent's probate estate. In a complete estate plan, with a funded trust, probate should not be necessary.

Once appointed, the Executor's main functions are to gather information about estate assets and liabilities, act as caretaker of the assets during the probate administration, and to keep accurate records of all estate transactions. These responsibilities specifically include the preparation of the estate inventory, the filing of various petitions to the probate court, and the preparation of the federal estate tax return, and estate income tax returns.

During administration of the estate, the Executor collects money and other assets belonging to the decedent on behalf of the estate and pays taxes and expenses on its behalf. The Executor is responsible for approving and paying, or

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rejecting, creditors' claims against the estate. The Executor also has the authority, subject at times to court approval, to execute legal documents and to sell estate assets. The final duty of the Executor is to distribute the assets in accordance with the terms of the will. At that time, the Executor is discharged.

The role of the Executor is important, but by its nature, it is temporary, lasting from nine months to a year in the simplest of cases and up to four or five years, or even longer, in very complicated estates. An Executor must be able to deal with the decedent's family and other heirs and should also have some appreciation for the decedent's financial position. However, an Executor has only limited investment responsibilities; as the caretaker of the estate assets, the Executor works to preserve the property during administration. The most common investment decision of an Executor is the selection of the assets which must be sold to raise the cash needed to pay taxes and the other costs of administration. For example, if the home must be sold to raise cash, the Executor may hire the real estate broker, approve the terms of the sale, execute the escrow instructions, and petition the probate court for approval of the sale. The Executor must also protect the estate by disposing of assets which may cause a loss to the estate (or by otherwise limiting the estate's exposure to loss). In short, the investment responsibilities of the Executor are generally exercised to raise cash and to limit losses rather than to invest estate assets for positive returns.

As part of his duties, the Executor must maintain meticulous records of all transactions. The records are the foundation of required court accountings and all tax returns.

Frequently, the Executor is the surviving spouse, a child, or another close relative of the decedent. In some cases, the person best suited to discharge these duties in a responsible and knowledgeable manner is the decedent's accountant or other advisor. Alternatively, the initial executor (or co-executor) may be a bank or trust company. Corporate fiduciaries are experienced in the management of estates. A corporate fiduciary brings the added advantages of being impartial and of having the people and procedures in place for efficient management and administration.

For a couple with young children, however, the Will usually serves as the place for nominating guardians for minor children should both parents die. During early married life when the estate is not large enough to require tax planning, the nomination of the guardian may be the primary purpose of a will.

The selection of a guardian of minor children is perhaps the most difficult decision parents must make in preparing their Wills. The selection of the guardian of the person is critical since that person will act as a substitute for the natural parents and will be responsible for raising the child until he or she reaches the age of majority, which is 18 years of age in California. During that period, the guardian will be the legal representative of the child, and as such, can authorize medical treatment, make educational and religious decisions, and generally exercise the legal authority of a parent. It is important to select an individual who is both capable and willing to serve in this responsible role.

A guardian may be nominated to serve in two capacities: he or she may act as the guardian of the minor's estate (provided there is no trust), in which case they will be charged with administering and overseeing property owned by the child; and/or as guardian of the person of the minor, which amounts to acting as a substitute for the child's natural parents. In many cases, the same individual is named as the guardian of both the person and the estate of a child.

While the trustee of a child's trust or the guardian of the child's estate may be legally empowered to reimburse the guardians of the person for costs of raising the children, there are indirect costs for raising children which may not be covered, such as the addition of a room to the home of the guardian or the need to purchase additional furniture. Parents should consider making special financial arrangements in their wills and trusts so that the guardians will not suffer an economic burden in caring for the children.

The guardian of the estate safeguards and invests the child's assets until he or she reaches age 18. Generally, it is better to establish a trust under the estate plan for the property going to a minor child than to use a guardian of his estate. The trust can be drafted to provide broad investment and invasion powers, while a guardianship is a creature of law and controlled by statutes. In addition, a guardian must release all assets to the child when the child reaches age 18. Therefore, a trust can postpone distribution of assets until a later age when the child may be more capable of using the money wisely. A trust is more flexible and may be structured to fit the particular needs of the child.

As with other representatives, it is important that successor guardians be named in the will. It is also important to consider whether one person or a married couple should be named as guardian and, if a married couple is named, to consider the effect a divorce of the guardians would have on that decision.

2.3. Revocable Living Trust

Revocable living trusts are the most commonly used tool in basic estate planning. A living trust avoids probate of person's estate, which is often a costly process and exposes the private, financial matters of a decedent to the public. The concept of a living trust as a will substitute has been a common estate planning tool for about 30 years. The process involves creating a trust, funding the trust with the individual's (or couples) assets and making certain that the principal assets are titled in the name of the Trustee. If the trust is created and not funded, a probate proceeding, using the "pour over" will most likely be required to implement the plan set forth in the Trust. The trust contains provisions applicable how to manage and distribute the income and principal during the life of the Settlor or Settlors, after the death of the first Settlor (if the Settlors are married or registered domestic partners) and after the second death (until distribution required by the trust instrument).

The living trust is managed by a trustee. The Settlor(s) usually serve(s) as the initial trustee. The successor trustee assumes control of the trust assets upon the incapacity or death of the Settlor(s). The choice of successor trustees is very important. Settlors have to choose between children, other family members, trusted advisors or corporate fiduciaries to act as successor trustees. Settlors often feel they are conveying a benefit on someone by naming them as trustee. Often being a trustee is more of a burden than anything else.

The trustee should have the financial, business and investment acumen to invest and manage the trust assets. Accurate record keeping is essential to the performance of the investment responsibilities. In addition, the trustee should have the ability to be sensitive to the needs of the beneficiaries of the trust.

Depending on the situation, a Settlor may want to name an individual to act together with an institutional cotrustee. Such cotrustee arrangements are designed to combine the best of the individual and institutional skills. The bank or trust company performs most of the daily tasks of the trustee (including the record keeping, preparation of tax returns, insuring and safeguarding of assets, and the management and investment of trust assets). On the other hand, the individual trustee (typically a family member) offers greater sensitivity and appreciation of the family situation. In other cases, an individual is nominated as trustee with the power to hire an institution to perform the investment, custodial and record keeping functions. Alternatively, the bank or trust company may be nominated as the trustee with the power in a beneficiary to veto investments, direct the investment of trust assets, or hire an investment advisor.

From time to time it is necessary to nominate a trustee to discharge a limited function, such as deciding on additional payments to minor children or controlling life insurance policies owned by the trust. These trustees are typically referred to as "special" trustees and they are appointed for specific tax or family purposes. These trustees should be selected based on their particular duties.

Since a trust is often drafted to last for long periods of time, the ultimate successor trustee should be a well-established bank or trust company because of their unlimited life.

2.4. Conservatorships.

Even with the best of planning, sometimes conservatorship is necessary. This can occur when a person develops some form of diminished capacity and needs protection from undue influence, requires administration of psychotropic drugs or is required to be placed in a locked facility for their own safety.

A person engaging in estate planning should also consider the nomination of a conservator. A conservator serves the same function as a guardian except that a conservator cares for an adult, where a guardian cares for a minor child. A conservator is appointed in a formal court proceeding and acts when a person is unable to care for himself, either personally or financially. As with guardians, a conservator can be the conservator of the person or the conservator of a person's estate (property) or both.

This function can be either long term or short term and should be assigned to someone who is willing to undertake the responsibility. Most frequently, family members are nominated as conservators, but private professional fiduciaries should be considered under the right circumstances.

2.5. Closing Remarks.

Each individual or institution chosen to act on behalf of a person or his or her estate has a particular function to perform. Financial experience, responsibility, attention to detail, and sensitivity to individual needs are common to all of the representatives, but differ in degree depending on the particular capacity in which the representative is to serve.

The primary qualities necessary for an executor are the ability to gather information relating to the estate for probate and tax purposes, to act as caretaker of estate assets, and to maintain accurate records during the administration period. The executor discharges his duties over a relatively short period of time.

A trustee needs to have the record keeping abilities associated with a good executor, but must also have strong financial and investment knowledge in order to administer the trust successfully over long periods.

Guardians and conservators of the person are responsible for the personal care of the individual with whom they are charged. On the other hand, guardians and conservators of estates require many of the attributes associated with trustees.

Careful consideration of the individuals and institutions who will act in these positions should be made at the very outset of the estate planning process. The estate plan, no matter how well designed, will depend on these representatives for successful completion of its goals.

ARTICLE THREE

INTRO TO ADVANCED ESTATE PLANNING

The basic estate plan is usually structured to be tax efficient and to take advantage of the applicable exclusion amount available to each individual.

This amount is currently $5,340,000 per person and is indexed for inflation. That means, if structured properly, a couple could pass $10,680,000 to their children or future generations without estate taxes, assuming no future reductions in the applicable exclusion amount.

For individuals with estates in excess of $10,680,000, or with the potential of exceeding this amount in the future, there are other tools available to minimize the tax burdens incumbent with transferring significant wealth. These tools include: 1) discounts results from gifting or selling minority interest, 2) intra-family loans (taking advantage of current low interest rates), 3) irrevocable trusts to hold gifted assets and transfer appreciation to future generations, 4) life insurance trusts (a form of irrevocable trust) to keep death benefit out of a decedent's taxable estate; 5) defective grantor trusts (irrevocable trusts structured for income tax additional benefits to beneficiaries); 6) dynasty trusts – for multiple generation planning (in addition to the estate tax there is an addition generation skipping transfer tax or transfers to grandchildren and more remote generations); 7) creating partnership or limited liability companies for succession and wealth transfer planning (discounting is an aspect of benefits from these entities, often used in conjunction with irrevocable trusts; 8) charitable gifting (using trusts and foundations); and 9) utilizing "family bank" concept (paying medical and school expenses directly – these are non-taxable gifts if paid directly to provider or institution). These are just a few of the tools available. Each situation is unique and requires careful analysis and planning. There is no one size fits all.

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