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Estate Planning Basics

1. What is estate planning?

Estate planning is a process. It involves people—your family, other individuals and, in many cases, charitable organizations of your choice. It also involves your assets (your property) and the various forms of ownership and title that those assets may take. And it addresses your future needs in case you ever become unable to care for yourself.

Through estate planning, you can determine:

- **Management:** How and by whom your assets will be managed for your benefit during your lifetime if you ever become unable to manage them yourself.
- **Lifetime Gifts**: When and under what circumstances it makes sense to distribute your assets during your lifetime.
- **Gifts at Death:** How and to whom your assets will be distributed after your death.
- **Heath Care:** How and by whom your personal care will be managed and how health care decisions will be made during your lifetime if you become unable to care for yourself.

Many people mistakenly think that estate planning only involves the writing of a will. Estate planning, however, can also involve financial, tax, medical and business planning. A will is part of the planning process, but you will need other documents as well to fully address your estate planning needs.

The purpose of this writing is to summarize the estate planning process, and illustrate how it can help you meet your goals and objectives. You will discover that estate planning is a dynamic process. Just as people and assets and laws change, it may well be necessary to adjust your estate plan every so often to reflect those changes.

2. What is involved in estate planning?

There are many issues to consider in creating an estate plan. First of all, ask yourself the following questions:

- What are my assets and what is their approximate value?

- Whom do I want to receive those assets—and when?
- Who should manage those assets if I cannot—either during my lifetime or after my death?
- Who should be responsible for taking care of my minor children if I become unable to care for them myself?
- Who should make decisions on my behalf concerning my care and welfare if I become unable to care for myself?
- What do I want done with my remains after I die and where would I want them buried, scattered or otherwise laid to rest?

3. Who needs estate planning?

You do—whether your estate is large or small. Either way, you should designate someone to manage your assets and make health care and personal care decisions for you if you ever become unable to do so for yourself.

If your estate is small, you may simply focus on who will receive your assets after your death, and who should manage your estate, pay your last debts and handle the distribution of your assets.

If your estate is large, your lawyer will also discuss various ways of preserving your assets for your beneficiaries and of reducing or postponing the amount of estate tax which otherwise might be payable after your death.

If you fail to plan ahead, a judge will simply appoint someone to handle your assets and personal care. And your assets will be distributed to your heirs according to a set of rules known as intestate succession. Contrary to popular myth, everything does not automatically go to the state if you die without a will. Your relatives, no matter how remote, and, in some cases, the relatives of your spouse will have priority in inheritance ahead of the state.

Still, they may not be your choice of heirs; an estate plan gives you much greater control over who will inherit your assets after your death.

4. What is included in my estate?

All of your assets. This could include assets held in your name alone or jointly with others, assets such as bank accounts, real estate, stocks and bonds, and furniture, cars and jewelry.

Your assets may also include life insurance proceeds, retirement accounts and payments that are due to you (such as a tax refund, outstanding loan or inheritance). The value of your estate is equal to the “fair market value” of all of your various types of property—after you have deducted your debts (your car loan, for example, and any mortgage on your home.)

The value of your estate is important in determining whether your estate will be subject to estate taxes after your death *(see #11*) and whether your beneficiaries could later be subject to capital gains taxes. Ensuring that there will be sufficient resources to pay such taxes is another important part of the estate planning process.

5. What is a will?

A will is a traditional legal document which:

- Names individuals (or charitable organizations) who will receive your assets after your death, either by outright gift or in a trust.
- Nominates an executor who will be appointed and supervised by the probate court to manage your estate; pay your debts, expenses and taxes; and distribute your estate according to the instructions in your will.
- Nominates guardians for your minor children.

Most assets in your name alone at your death will be subject to your will. Some exceptions include securities accounts and bank accounts that have designated beneficiaries, life insurance policies, IRAs and other tax-deferred retirement plans, and some annuities.

Such assets would pass directly to the beneficiaries and would not be included in your will (*see #13*). In addition, certain co-owned assets (*see #12*) would pass directly to the surviving co-owner regardless of any instructions in your will. And assets that have been transferred to a revocable living trust (*see #6*) would be distributed through the trust—not your will.

6. What is a revocable living trust?

It is a legal document that can, in some cases, partially substitute for a will. With a revocable living trust (also known as a revocable inter vivos trust or grantor trust), your assets are put into the trust, administered for your benefit during your lifetime and transferred to your beneficiaries when you die—all without the need for court involvement.

Most people name themselves as the trustee in charge of managing their living trust's assets. By naming yourself as trustee, you can remain in control of the assets during your lifetime. In addition, you can revoke or change any terms of the trust at any time as long as you are still competent. (The terms of the trust become irrevocable when you die.)

In your trust agreement, you will also name a successor trustee (a person or institution) who will take over as the trustee and manage the trust's assets if you should ever become unable to do so. Your successor trustee would also take over the management and distribution of your assets when you die.

A living trust does not, however, remove all need for a will. Generally, you would still need a will—known as a pour over will—to cover any assets that have not been transferred to the trust.

Once your trust has been signed, an important task remains. To avoid court-supervised conservatorship proceedings if you should become incapacitated, or the probate process at your death, your assets must be transferred to the trustee of your living trust. This is known as *funding* the trust.

Deeds to your real estate must be prepared and recorded. Bank accounts and stock and bond accounts or certificates must be transferred as well. These tasks are not necessarily expensive, but they are important and do require some paperwork.

A living trust can hold both separate and community property. This makes it convenient for spouses and registered domestic partners to plan for the management and ultimate distribution of their assets in one document.

If you own real estate in another state, you might (depending on that state's law) transfer that asset to your trust as well to avoid probate in that other state. A lawyer from that state can help you prepare the deed and complete the transfer. If the real estate is located in California, a California lawyer should prepare the deed and advise you on transferring such property.

A lawyer can help you transfer other assets as well. For example, you should consider changing the beneficiary designations on life insurance to the trust. As for the beneficiary designations on a qualified plan (such as a 401(k) or an IRA), you should seek a qualified professional's advice because there are serious income tax issues.

7. What is probate?

Probate is a court-supervised process for transferring a deceased person's assets to the beneficiaries listed in his or her will.

Typically, the executor named in your will would start the process after your death by filing a petition in court and seeking appointment. Your executor would then take charge of your assets, pay your debts and, after receiving court approval, distribute the rest of your estate to your beneficiaries. If you were to die intestate (that is, without a will), a relative or other interested person could start the process.

In such an instance, the court would appoint an administrator to handle your estate. Personal representative is another term used to describe the administrator or executor appointed to handle an estate. Simpler procedures are available for transferring property to a spouse or for handling estates in which the total assets amount to less than $150,000. The probate process has advantages and disadvantages.

The probate court is accustomed to resolving disputes about the distribution of assets fairly quickly through a process with defined rules. In addition, the probate court reviews the personal representative's handling of each estate, which can help protect the beneficiaries' interests.

One disadvantage, however, is that probates are public. Your estate plan and the value of your assets will become a public record. Also, because lawyer's fees and executor's commissions are based on a statutory fee schedule, a probate may cost more than the management and distribution of a comparable estate under a living trust.

Time can be a factor as well. A probate proceeding generally takes longer than the administration of a living trust.

8. Can I name alternative beneficiaries?

Yes. You should consider alternative beneficiaries in the event that your primary beneficiary does not survive you. And if a beneficiary is too young or too disabled to handle an inheritance, you might consider setting up a trust for his or her benefit under your will or living trust.

9. Who should be my executor or trustee?

That is your decision. You could name your spouse or domestic partner as your executor or trustee. Or you might choose an adult child, another relative, a family friend, a business associate or a professional fiduciary such as a bank. Your executor or trustee does not need any special training. What is most important is that your chosen executor or trustee is organized, prudent, responsible and honest.

While the executor of a will is subject to direct court supervision and the trustee of a living trust is not, they serve almost identical functions. Both are responsible for ensuring that your written instructions are followed.

One difference is that the trustee of your living trust may assume responsibilities under the trust agreement while you are still living (if you ever become unable or unwilling to continue serving as trustee yourself).

There are many issues to consider when choosing an executor or trustee. For example, will the appointment of one of your adult children hurt his or her relationship with any other siblings? What conflicts of interest would be created if you name a business associate or partner as your executor or trustee? And will the person named as executor or successor trustee have the time, organizational ability and experience to do the job effectively?

10. How should I provide for my minor children?

First of all, in your will, you should nominate a guardian to supervise and care for your child (and to manage the child's assets) until he or she is 18 years old.

Under California law, a minor child (a child under age 18) would not be legally qualified to care for himself or herself if both parents were to die. Nor is a minor legally qualified to manage his or her own property.

Your nomination of a guardian could avoid a "tug of war" between well-meaning family members and others. You also might consider transferring assets to a custodian account under the California Uniform Transfers to Minors Act to be held for the child until he or she reaches age 18, 21 or 25. Or you might consider setting up a trust to be held, administered and distributed for the child's benefit until the child is even older.

11. When does estate planning involve tax planning?

For the year 2014, estate taxes are imposed upon estates that have a net value of $5.34 million or more. This is called the estate tax exemption. For a married couple, the exemption is $10.68 million. For estates that approach or exceed these amounts, significant estate taxes can be saved by proper estate planning, usually before your death or, for couples, before one of you dies.

Keep in mind that tax laws often change. And, estate planning for tax purposes must take into account not only estate taxes, but also income, capital gains, gift, property and generation-skipping taxes as well.

12. Does the way in which I hold title make a difference?

Yes! The nature of your assets and how you hold title to those assets is a critical factor in the estate planning process. Before you take title (or change title) to an asset, you should understand the tax and other consequences of any proposed change. Your estate planning lawyer will be able to advise you.

- <u>Community property and separate property</u>. If you are married or a registered domestic partner, assets earned by either you or your spouse or domestic partner while married or in the partnership and while a resident of California are community property. (Note: Earned income in domestic partnerships, however, may not be treated as community property for federal income tax purposes.)

As a married individual or registered domestic partner, you may continue to own certain separate property as well—property which you owned prior to the marriage or domestic partnership. A gift or inheritance received during the marriage or partnership would be considered separate property as well.

Separate property can be converted to community property (and vice versa) by a written agreement (it must conform with California law) signed by both spouses. However, taking such a step can have significant tax and other consequences. Make sure that you understand such consequences before making any such change.

- Tenants-in-common. If you own property as tenants in common and one co-tenant (co-owner) dies, that co-tenant's interest in the property would pass to the beneficiary named in his or her will. This would apply to co-tenants who are married or in a domestic partnership as well as to those who are single.

- Joint tenancy with right of survivorship. Co-owners (married or not) of a property can also hold title as joint tenants with right of survivorship. If one tenant were to die in such a situation, the property would simply pass to the surviving joint tenant without being affected by the deceased person's will.

- Community property with right of survivorship. If you are married or in a registered domestic partnership, you and your spouse or partner could also hold title to property as community property with right of survivorship. Then, if your spouse or domestic partner were to die, the property would pass to you without being affected by the deceased person's will.

  Married couples and registered domestic partners also have the option of jointly holding title to property as community property. In such a situation, if one spouse or partner were to die, his or her interest would be distributed according to the instructions in his or her will.

13. Are there other ways of leaving property?

Yes. Certain kinds of assets are transferred directly to the named beneficiaries. Such assets include:

- Life insurance proceeds.
- Qualified or non-qualified retirement plans, including 401(k) plans and IRAs.
- Certain "trustee" bank accounts.

- Transfer on death (or TOD) securities accounts.
- Pay on death (or POD) assets, a common title on U.S. savings bonds.

Keep in mind that these beneficiary designations can have significant tax benefits and consequences for your beneficiaries—and must be carefully coordinated with your overall estate plan.

14. What happens if I become unable to care for myself?

You can help determine what will happen by making your own arrangements in advance. Through estate planning, you can choose those who will care for you and your estate if you ever become unable to do so for yourself. Just make sure that your choices are documented in writing.

If you set up a living trust, for example, the trustee will provide the necessary management of those assets held in trust. You should also consider setting up a durable power of attorney for property management to handle limited financial transactions and to deal with assets that may not have been transferred to your living trust. By doing this, you designate an agent or attorney-in-fact to make financial decisions and manage your assets on your behalf if you become unable to do so.

And by setting up an advance health care directive/durable power of attorney for health care, you can also designate an attorney-in-fact to make health care decisions for you if you ever become unable to make such decisions. In addition, this legal document can contain your wishes concerning such matters as life-sustaining treatment and other health care issues and instructions concerning organ donation, disposition of remains and your funeral.

Both of these attorneys-in-fact lose the authority to make decisions on your behalf when you die. If you have not made any such arrangements in advance and you become unable to make sound decisions or care for yourself, a court could appoint a court-supervised conservator to manage your affairs and be responsible for your care.

The court's supervision of the conservator may provide you with some added safeguards. However, conservatorships can also be more cumbersome, expensive and time-consuming than the appointment of attorneys-in-fact under powers of attorney.

In any event, even if you appoint attorneys-in-fact who could manage your assets and make future health care decisions for you, you should still document your choice of conservators in case a conservatorship is ever necessary.