Q&A: ESTATE PLANNING, PROBATE, & TRUSTS

1. WHAT IS ESTATE PLANNING?

Estate Planning is a ***process*** that is undertaken in several steps. One step involves taking an inventory of all of the real and personal property that one owns or in which one holds an interest. Another step involves planning for the management and disposition of that property during one's lifetime. Another step involves planning for the management and disposition of that property after death. Yet another step involves planning for one's ***health care*** in the event of incapacity and the subsequent inability to manage one's financial affairs.

Most people who call us for assistance think that the process of planning your estate means only the preparation of a **Last Will & Testament**. But estate planning is much more involved and encompasses the preparation of a number of documents. Estate planning may involve financial, tax, medical, and business planning, ***in addition to*** the preparation of a **Last Will & Testament**. The purpose of this document is to summarize the estate planning process and get you to think about what estate planning might entail for you.

2. WHO NEEDS ESTATE PLANNING?

Almost everyone, regardless of the ***value of the property*** in his or her estate, or the ***variety of the property*** in his or her estate, or his or her ***marital status***, or his or her ***parental status***, needs estate planning.

If your estate is small and truly uncomplicated, your estate planning may only focus upon who is to care for you upon your incapacity, who is to receive your property after your death and, more importantly, who should be the guardian of any of your children who are minors at your death. If your estate is larger, you should be concerned not only with the foregoing, but also with the different ways to preserve your property for your heirs. ***For example***, estate planning often involves planning to reduce or eliminate the amount of estate taxes (also known as "death taxes" or "inheritance taxes") which otherwise might be payable on your death, and planning to protect property for disabled beneficiaries.

Regardless of the size and complexity of your estate, or your marital or parental status, if you become incapacitated, you will be unable to manage your own affairs or make medical decisions on your own behalf. Thus you should not only plan for the management and disposition of your property after your death, but also for the management and disposition of your property should you become incapacitated prior to death. You should designate who, in the event of your incapacity, shall have the legal authority to manage your affairs, to care for you, and to make health care decisions on your behalf.

At a minimum, therefore, in addition to a **Last Will & Testament**, everyone should have a **Durable Power of Attorney for Financial Affairs** and an **Advance Health Care Directive**.

3. WHAT IS INVOLVED IN ESTATE PLANNING?

Generally, the form, variety, and complexity of the documents that make up your estate plan will depend upon your personal circumstances, including the nature, variety, value, and character of the assets you own, your particular needs and objectives, and the needs of your beneficiaries. And, of course you will want to minimize estate taxes and the costs involved in the administration of your estate.

During the estate planning process, you must address a number of important questions, including the following:

- If you become unable to care for yourself, **WHO** will care of you and make decisions regarding your medical needs?
- If you become unable to manage your business and financial affairs, **WHO** will oversee and manage these affairs on your behalf during your remaining lifetime?
- **WHO** should be the guardian of any children who may be minors at your death?

- **HOW** should you and your spouse hold legal title to your assets (e.g., husband and wife, as joint tenants, or husband and wife as community property with right of survivorship, or as the separate property of one or the other of you)?
- Upon your death, **WHO** should administer your estate, i.e., who should act as the Executor of your **Last Will & Testament** or the Successor Trustee of your trust?
- **HOW** can the federal estate and other taxes assessed against the property of your estate be minimized or even eliminated while not adversely affecting your other, **non-tax** objectives?
- **HOW** will your Executor or Successor Trustee pay estate taxes and debts of your estate if any are due, i.e., from what sources will your Executor or Successor Trustee have the liquidity with which to pay your debts and taxes?
- **HOW** should your property be distributed to your beneficiaries upon your death? Outright or in trust?
- **WHO** should receive the proceeds of your life insurance or your retirement benefits? Is that person old enough to receive the proceeds outright, or is a guardianship necessary for him or her?

4. WHAT PROPERTY IS INCLUDED IN YOUR ESTATE?

Your "estate" includes all of the property you own, ***including*** property that you may never use yourself during your lifetime, such as the proceeds from an insurance policy that insures your life, or retirement plan proceeds remaining at your death. Your ***gross estate*** is the sum of the "fair market value" of each of the assets in your estate (before deducting for debts, mortgages, obligations, etc.). Your ***gross estate*** includes all of the following assets:

- Your ***tangible personal property*** (e.g., your tools, documents, papers, furniture, clothing, letters, photos, artwork, equipment, automobiles – generally anything that you can touch);
- Your ***intangible personal property*** (e.g., cash held in bank accounts and other financial institutions, financial investments, retirement plans, insurance policies (***except*** term policies), interests in family businesses, interests in general & limited partnerships, royalties, copyrights, patents stock options – in short, anything of value that cannot be physically touched or held in your hands); and
- Your ***real property***, or interests in real property that you own [i.e., your real property includes your right, title, and interest in your land, your home, and any rental real property (e.g., apartment building, commercial property, etc.) in which you hold an interest].

In general, "fair market value" of an asset may be thought of as its present value or the cost of purchasing that particular asset at the relevant time (i.e., the date of your death). As part of the estate planning process, you should create an inventory list of all of the property that you own (whether you hold title separately in your own name, or with another person or persons as joint tenants, or tenants in common, or in your trust, or as an interest in a partnership, etc.) and the approximate fair market value of the property. The value of your estate is important in determining whether, and to what extent, your estate will be taxed after your death and/or the resources or assets that you will have available to pay your medical and financial expenses in the event of your incapacity. The value of your estate is also important in determining what, if any, additional measures should be taken to minimize estate taxes upon your death.

5. WHAT PART OF YOUR ESTATE IS SUBJECT TO ESTATE TAXES?

Generally, your ***gross estate*** is equal to the total fair market value of each asset that you own. Your ***taxable estate*** is equal to your gross estate LESS the total value of your ***debts*** at death. Your ***debts*** include a mortgage on a home, credit card debts, unsecured loans, income taxes, etc., and other ***deductions*** (e.g., administrative expenses, debts related to your last illness, etc.). Then, your ***net taxable estate*** is computed by subtracting from your ***taxable estate*** the value of all property that passes (at your death) to your spouse or to charity. Your ***net taxable estate*** is subject to estate taxes.

6. WHAT IS A LAST WILL & TESTAMENT?

A **Last Will & Testament** is the legal document by which you identify those individuals (or charities) that are to receive your property and possessions on your death. These individuals and charities are commonly referred to as the ***beneficiaries*** under your **Last Will & Testament**. In addition, within the provisions of your **Last Will & Testament**, you nominate an ***Executor*** to be responsible for the proper administration of your estate and the disposition of your property to your intended beneficiaries. The ***Executor*** may be an individual or a bank or other financial institution. After your death, the person or entity you have nominated to be your Executor petitions the court to be appointed Executor of your estate. After being appointed, the Executor manages your estate's financial affairs, protects and oversees your property, and ensures that your property is distributed in accordance with your wishes as indicated in the **Last Will & Testament**.

Also, if you have young children, you may use the **Last Will & Testament** to nominate a Guardian(s) for your children who are under 18 years at the time of your death and for whom a guardianship would be necessary (i.e., meaning that your children's other parent is already deceased at your death).

Warning! Great care must be taken when you execute (i.e., ***sign***) your **Last Will & Testament**. California law requires that one must follow certain steps to properly execute a **Last Will & Testament**. The failure to execute your **Last Will & Testament** in the proper manner may invalidate the entire document — thereby frustrating your intentions with regard to the disposition of your property on your death! Indeed, the failure to execute one's **Last Will & Testament** in the proper manner is one of the most common reasons for invalidating the **Last Will & Testament** ***in its entirety***. In addition, if you wish to make changes to your **Last Will & Testament**—even changes that appear simple to you—you must do so in a very specific manner or else that particular change or even the entire document will be invalidated.

7. WHAT IS A REVOCABLE INTER VIVOS TRUST?

Generally, a **Revocable Inter Vivos Trust** (sometimes called a "revocable living trust") is a written agreement between the individual creating the trust (who is commonly known as a "***Settlor***," "***Grantor***," or "***Trustor***") and the person or institution that is to manage the assets held in trust (commonly known as the "***Trustee***"). The trust is established to provide that the assets it holds are to be for the lifetime benefit of the Settlor. The Trustee may be either an individual or a bank or other financial institution. Of course, you can serve as the Initial Trustee of a revocable living trust that you created. However, upon your incapacity or your death, someone else "steps into the office of Trustee" and continues to manage your trust for your lifetime benefit (if you are still living) or the benefit of your beneficiaries (if you have died).

Since the trust is ***revocable*** (i.e. amendable), you (in your capacity as the Settlor) can amend, modify, or revoke the provisions governing the trust at any time during your lifetime while you are competent. Moreover, during your lifetime, you are usually the sole ***beneficiary*** of the trust and are entitled to all of the income earned by the trust's assets. In addition, if needed, you are entitled to all of the trust assets themselves.

Under the terms of the trust agreement, the Trustee has the legal right to manage or control the property held in the trust. The Trustee has the responsibility to identify the persons or institutions ("beneficiaries") who are to receive income earned by the assets held in the trust or the assets themselves (the trust principal). If you are the Initial Trustee, you have the power to manage the trust assets in the same manner and to the same degree that you would have been able to do before you established the trust (i.e., as Trustee, you can open & close bank/investment accounts, purchase real property, sell property, deal with the investment property, etc.).

If the Trustee is someone other than the Settlor, the Trustee acts as a ***fiduciary*** and occupies a position of trust and confidence. The Trustee is subject to strict fiduciary responsibilities. This means that the Trustee is held to very high standards of performance in the management and control of the assets held in the trust. Usually, a Trustee (if s/he is ***not*** the person who established the trust) cannot use property for his/her own personal use, benefit, or self-interest. Instead, s/he must hold the trust property solely for the benefit of the beneficiaries of the trust.

Avoidance of Probate. A ***PRIMARY REASON*** for establishing a **Revocable Inter Vivos Trust** is to ***AVOID A PROBATE*** of your estate upon death. To the extent that your property is held in your **Revocable Inter Vivos Trust**, then that property will ***not*** be subject to probate upon your death.

But what does it mean to "hold your property in trust"? With only a few exceptions, the legal titles to all of a Settlor's assets must be changed from the Settlor's name ***as an individual*** to the Trustee's name as the Trustee of the **Revocable Inter Vivos Trust** before a probate of those assets can be avoided.

For example, if William Jones wishes to change the ownership of ***real property*** from his name as an unmarried man to himself as Trustee of his **Revocable Inter Vivos Trust**, which he created on February 18, 2007, he must execute a grant deed with the following or substantially similar language:

GRANTOR: William Jones, an unmarried man

HEREBY GRANTS TO:

GRANTOR: William Jones, Trustee of The William Jones 2007 Trust, Created UDT Dated 2/18/2007

The ***legal title*** or ***registration*** to a person's other assets, such as those assets held in joint tenancy or which pass by a designation of a beneficiary (like the proceeds of a life insurance policy or a 401(k) plan), need not be transferred to the Trustee to avoid a probate of those assets. However, there may be very good reasons to sever the joint tenancy title to these assets and transfer one's interest in that property to the Trustee.

In addition, your trust could be a ***beneficiary*** of your life insurance policy or retirement plan, although with regard to retirement plans, you must be very careful when designating beneficiaries because of unintended income tax consequences, especially when you designate your trust as a beneficiary of a retirement plan, including an IRA or 401(k) plan.

Warning! It is important to remember that, even if most, if not all, of your property is held in your trust, you should still ***always*** execute a **Last Will & Testament**. The reason is that, if upon your death, there are assets that are not held in your trust (i.e., due to oversight, neglect, or an inheritance late in your life that never is transferred into your trust), the provisions of a **Last Will & Testament** can direct the Executor to convey those assets to the Trustee of your trust so that they will be distributed in accordance with your wishes. If you have no **Last Will & Testament** in place at the time of your death—even if you have a trust in existence—the law treats you as having died ***intestate*** (dying without a valid will & testament in effect). As a result, the assets that are not held in your trust at your death will be transferred to your ***heirs at law***, rather than to the beneficiaries of your trust. In addition, a probate of those assets may be necessary. The identities of your ***heirs at law*** are determined with reference to California law and not with reference to your trust. Therefore, if your heirs at law are NOT the beneficiaries of your trust, those heirs will receive the property that is not held in your trust at your death (if you do not have a **Last Will & Testament** in place).

Avoidance of Conservatorship. Another ***PRIMARY REASON*** for establishing a **Revocable Inter Vivos Trust** is to avoid a conservatorship of your estate if you become incapacitated. (See immediately below for an explanation of a conservatorship.) The terms governing your **Revocable Inter Vivos Trust** provide that, if you become incapacitated, the person whom you have designated to act as Successor Trustee will become Trustee of the trust. This is a powerful benefit to you and your estate because conservatorship-related expenses and fees are quite substantial.

8. WHAT IS A CONSERVATORSHIP?

A ***conservatorship*** is a court-supervised proceeding in which a judge appoints an individual to take care of you and your property if you are unable to do so for yourself. A conservatorship is a very expensive, intrusive, and time-consuming process. However, there are advantages to a conservatorship in that it can prevent an incapacitated person from being abused, either financially or physically. However, when a person becomes incapacitated and does not have an adequate estate plan in place, there is usually no other way to prevent that

person from being financially or physically abused other than by loved ones petitioning the court to establish a conservatorship for the incapacitated individual.

9. TO WHOM SHOULD YOU LEAVE YOUR PROPERTY AT YOUR DEATH?

Regardless of whether a **Last Will & Testament** or a **Revocable Inter Vivos Trust** is the centerpiece of your estate plan, a primary purpose of these estate planning vehicles is to identify those persons or institutions that are to receive your property upon your death, and to determine how the property is to be distributed to them.

The beneficiaries who are to receive your property upon your death must be clearly identified. Disputes often arise after an individual dies because the identities of the beneficiaries who are to receive his or her property, or the terms and conditions under which those beneficiaries are to receive property are unclear and ambiguous. Therefore, you must use great care to clearly indicate who is to receive your property upon your death, and the manner in which s/he is to receive such property. For example, should a particular beneficiary receive his share of your estate outright OR should the beneficiary's share of your estate be held in a trust that is managed for his benefit (i.e., due to the beneficiary's inability to be prudent with the property or because the beneficiary is disabled, etc.)?

Also, you should always keep in mind that your expectations regarding the natural order of deaths may not, in fact, occur (i.e., sometimes children die before their parents, etc.). Therefore, you should address those unpleasant, but reasonably foreseeable events to minimize disputes after your death.

10. WHO SHOULD YOU DESIGNATE AS YOUR EXECUTOR OR TRUSTEE?

Upon a person's death, the Executor under a **Last Will & Testament** and the Trustee of a **Revocable Inter Vivos Trust** serve almost identical functions. Both the Executor and the Trustee are responsible for paying the debts of the deceased person, creating an inventory of the property s/he owned at the time of his/her death, and ensuring that the decedent's wishes, as expressed in his **Last Will & Testament** or **Revocable Inter Vivos Trust**, are fully implemented. Although the Executor is generally subject to supervision by a court, both the Executor and the Trustee have similar fiduciary responsibilities.

Because a **Revocable Inter Vivos Trust** is established while the Settlor is living, the Settlor will act as the ***initial*** Trustee of the trust as long as s/he is capable of doing so. Thus, the Settlor continues to manage and distribute trust assets for his or her own benefit. If you decide to establish a **Revocable Inter Vivos Trust**, the decision whether to act as the initial Trustee is your decision, made after consultation with your family and trusted advisors. However, if you become incapable of functioning as a Trustee (either due to your incapacity or death), your designated successor Trustee will assume the "office of Trustee" and act as Successor Trustee of your trust. (Of course, since your **Last Will & Testament** is not triggered into effect until your death, by definition, you cannot serve as the Executor of your **Last Will & Testament**.)

The persons who are often named as one's Executors or successor Trustees include spouses, adult children, other trusted relatives, family friends, business associates, or financial institutions (banks or trust companies). When deciding on the person(s) to act as an Executor or a Trustee, take care to select someone who is responsible, well organized, and somewhat experienced in maintaining accounts and records. In addition, it is useful for an Executor or successor Trustee to have had business experience and to have acquired some basic knowledge about making investments. However, the most important requirement for this position is that the person has the ability to exercise good common sense.

11. WHAT IS A PROBATE?

Probate is a court-supervised process that has as its ultimate goal the transfer of property from an individual who has died (the "decedent") to that individual's beneficiaries who are identified in his/her **Last Will & Testament** or, if the decedent died without a **Last Will & Testament** in place, to that decedent's ***heirs at law***, such persons being described under California law (surviving spouse, children, siblings, etc.). Generally, your "***probate***

estate" (which is a subset of your entire estate) consists of any property whose legal title at the time of your death is held in your name as an individual. Any property that you hold with other persons in ***joint tenancy*** or in your name as Trustee of your living trust is usually NOT part of your probate estate and thus, such property avoids being probated at your death.

Under current law, a ***formal probate*** of your estate is required if, upon your death, the cumulative fair market value of the property in your ***probate estate*** at the time of your death equals or exceeds $100,000. For purposes of this calculation, the gross fair market value of the property is used to determine if a formal probate is necessary (i.e., you would not subtract your debts and mortgages from your property before determining if a formal probate of your estate would be necessary).

ADVANTAGES OF PROBATE. The advantages of a probate proceeding include quick resolution of disputes between beneficiaries. For example, if a dispute arises between beneficiaries or heirs of an estate regarding the distribution of your property, the probate court is very well-suited to resolve such disputes expeditiously and in accordance with well-defined rules. Another advantage of probate is the quick resolution of creditor's claims. Creditors must file their claims against your estate (i.e., to collect on your debts that existed at the time of death) more quickly in the probate proceeding than when the estate passes via a trust administration or otherwise (i.e., Creditors generally have 4 months to file their claims versus one year or longer to file their claims when one's estate passes via a trust).♦/

DISADVANTAGES OF PROBATE. The disadvantages of a probate when compared to the administration of a trust upon one's death include its public nature, its much higher cost, and the usually greater delay in finalizing the administration of the decedent's estate.

Probate fees and expenses include (1) the cost of filing a Petition for Probate of your estate; (2) the compensation paid to the Executor of the estate, and (3) the compensation paid to the Attorney the Executor retains to assist him or her with the administration of the estate. Other expenses include fees paid to probate referees (a requirement of the court) to appraise the property in the probate estate.

Fees to the Executor & Attorney for the Executor. The amount of compensation that is paid to the Executor of the Estate and his or her Attorney are governed by California law. In general, the probate fees paid to an Executor amount to about 2.5% of the gross value of the probate estate for ***ordinary services***. The probate fees paid to the Executor's Attorney amount to ***an additional*** 2.5% of the gross value of the probate estate for ***ordinary services***.

For example, assume that at the time Mr. Wilson died, the property comprising his probate estate was valued at $2,500,000. The assets in the probate estate consisted of a home valued at $1,000,000, and cash, securities, and other property valued at 1,500,000.

The Executor's fees for ***ordinary services*** to probate Mr. Wilson's estate will total **$38,000**. In addition, the fees paid to the Attorney for the Executor for ordinary services will also total **$38,000**. Therefore, the total probate fees for ***ordinary services*** to probate Mr. Wilson's estate will be **$76,000**.♣/ Keep in mind that debts (including mortgages, consumer debt, taxes, etc.) are not considered when determining the size of the estate for the purpose of calculating compensation paid to the Executor and his/her Attorney.

♦/ California law does provide a mechanism whereby, during a trust administration (with no probate in process), creditors would have the same shorter period of time (4 months) to file claims against a trust (after one's death); however this process can increase the complexity and the cost of the trust administration.

♣/ ***Ordinary services*** do not include fees for time spent by the Executor and/or the Attorney on such issues as preparing tax returns, selling real property, clearing a predeceased owner's name off of property that now belongs to the decedent, or any contests of the decedent's **Last Will & Testament**. Those fees are considered *extraordinary*, and therefore added to the *ordinary* fees owed to the Attorney and/or the Executor. As you can see, fees to administer a decedent's estate through probate are quite high indeed.

The table below summarizes how the fees paid to the Executor and to the Executor's attorney are calculated:

Percentage of Probate Estate	Fee for Executor	Fee for Attorney
4% of the first $100,000	$4,000.00	$4,000.00
3% of the next $100,000	$3,000.00	$3,000.00
2% of the next $800,000	$16,000.00	$16,000.00
1% of the next $1,500,000	$15,000.00	$15,000.00
STATUTORY FEES ON ESTATE OF $2,500,000:	$38,000.00	$38,000.00

12. WHAT IS A TRUST ADMINISTRATION?

An administration of a trust is required upon the death of the person who established the trust. If the legal title to the bulk of the property in your estate is held by the Trustee of your trust, then the administration and distribution of that property upon your death is handled much more simply, much more quickly, and at much less expense than if that property had to be probated. A trust administration is NOT usually a court-supervised process. Yet its ultimate goal is also the transfer of property from an individual who has died (the "decedent") to that individual's beneficiaries, as identified in the document governing the trust.

Therefore, the advantages of a trust administration over a probate proceeding include a quicker distribution of the property to beneficiaries, its far more private nature due to no court supervision of the process (i.e., no proceedings in court), and, usually, it is a less expensive manner of distributing property to beneficiaries.

Costs to Administer Trust Lower than Probate. As indicated above, probate fees include the compensation paid to the Executor of the estate and the Attorney the Executor retains to assist him or her with the administration of the estate. Such compensation is fixed by law. By contrast, the fees to administer a trust, which include the fees paid to the Trustee and the Attorney the Trustee retains to assist with the trust administration are not set by law. Usually, these fees are paid with some reference to the actual amount of time needed to administer the trust. This often results in a much lower cost to the estate than if a probate were necessary. In addition, there are no filing fees to pay.

13. WHAT OTHER KINDS OF TRUSTS ARE USED IN ESTATE PLANNING?

Trusts serve a wide variety of needs in estate planning; they may be established for the benefit of a child, a disabled or incapacitated individual, a charity, or to minimize estate taxes upon death. Common examples of these types of trusts include ***special needs trusts***, ***life insurance trusts***, and ***charitable remainder trusts***. All of these trusts are usually ***irrevocable*** trusts, which means that the provisions governing them cannot be changed nor can they be terminated at will. However, despite the requirement that these trusts must usually be irrevocable, there are often ways to provide some flexibility during the term of an irrevocable trust to deal with unexpected circumstances or changes in law.

A ***life insurance trust*** allows for the organized management of the proceeds of a life insurance policy on the death of the insured. In addition, if a life insurance trust is properly created and operated, the proceeds of a life insurance policy that is held in the life insurance trust will not be included in the estate of the insured upon his/her death. Therefore, the proceeds will not be subject to any federal estate taxes. However, to avoid federal estate taxes, a life insurance trust must usually be ***irrevocable***.

A ***special needs trust*** allows for property to be managed by a Trustee for the lifetime benefit of a disabled beneficiary. A primary advantage of this kind of trust is that the assets held in the trust will not prevent the disabled beneficiary from qualifying for benefits from various governmental benefits programs. Special needs trusts may be either irrevocable or revocable, depending on certain circumstances, especially the original ownership of the property held in the trust.

A ***charitable remainder trust*** allows for property to be managed for the lifetime benefit of a non-charitable beneficiary (spouse or children) with the assets remaining at the death of those beneficiaries being transferred to charity. A charitable remainder trust must almost always be irrevocable to avoid federal estate taxes.

14. DOES ESTATE PLANNING INVOLVE TAX PLANNING?

Often the creation of a will or a revocable inter vivos trust will involve substantial tax planning, particularly for larger estates. Estate planning generally focuses upon federal estate taxes, but also may encompass income, gift, generation-skipping, real property or qualified retirement plan taxes. Generally, federal estate taxes will be due when the total value of all the property in the estate equals or exceeds $2,000,000 (for Year 2008). The surviving spouses of decedents who were married at the time of their deaths can elect to defer the estate taxes that would otherwise be due until their own deaths (i.e., this is the so-called "marital deduction"). Although proper planning can reduce or even eliminate these estate taxes, such planning usually must occur before death. **JC**

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