MICHAEL R. BROWN, A LAW CORPORATION

MASTER OF BUSINESS ADMINISTRATION
CERTIFIED PUBLIC ACCOUNTANT
CERTIFIED TAX SPECIALIST
(State Bar of California Board of Legal Specialization)

TAXATION
CORPORATE & BUSINESS LAW
ESTATE PLANNING

23041 Mill Creek Drive
Laguna Hills, California 92653-1257
mike@browntaxlaw.com

Telephone
(949) 452-0412
Facsimile
(949) 380-1128

OPTIONS IN ESTATE PLANNING

This Memorandum presents various options you should consider in planning your estate. The ultimate choice of estate plans depends not only on financial considerations, but on personal and family considerations as well. The options discussed here are by no means all-inclusive of estate planning techniques. They do, however, present the basis for any family's estate plan.

SIMPLE WILL

Designate Heirs

A will permits you to designate the individuals that you desire to leave your estate to. Without a will, the State of California has predetermined who your estate will be distributed to through the laws of intestacy.

Appoint Executor

A will also permits you to appoint an executor to govern the administrative aspects of probating your estate. Without a will, the Court will appoint an Executor/Administrator of it's choice.

Waive Executor's Bond

You may also waive the requirement of having your executor obtain a bond for the probate proceeding, but only if you so direct in your will. The bond fees saved can be substantial.

Nominate Guardians for Minor Children

If you are survived by a minor child, the court will need to appoint two guardians; one to care for the child and one to care for the child's share of the estate. A single person may serve in both capacities. If you nominate such guardians in your will, the court will almost always follow your suggestion.

Children Receive Inheritance at 18

Under the standard will, when a child reaches age 18, the guardian of the child's estate must turn it over to the child.

Administrative Advantages

There are certain other "administrative" advantages in the probate proceeding which you can obtain only if you have a valid will.

No Estate Tax Savings Provided

If a couple has a combined net worth of $1,500,000, estate taxes are not an immediate problem. In calculating net worth, it is important to included the proceeds of any life insurance policies you own. Insurance will often increase the value of your estate significantly.

If one spouse passes away and leaves their entire estate to the surviving spouse, there should be no estate tax on the transfer to the surviving spouse. Under Federal tax laws, any gift to a spouse during life or at death is a tax-free transfer.

Upon the death of the surviving spouse, their estate can be passed on to their heirs without incurring any estate tax liability, if their estate is less than $1,500,000. However, any amount in excess of $1,500,000 is taxed at a rate beginning at 45% and increasing to a maximum of 47%. Pension and IRA assets are also subject to income tax.

WILLS WITH A MINOR'S TRUST

Problem of Minors' Early Inheritance Under a Simple Will

A will with a minor's trust is similar to the will described above, but includes a trust to avoid distribution to immature heirs. Wills often pass all property to the surviving spouse. However, if that spouse is deceased, then the property goes to the children in equal shares. Without provisions to keep this property in trust for the children, the Property would go to a guardian for the minor children.

That guardian holds, manages and distributes each child's property for the benefit of that child until age 18, when it must be distributed to the child outright. Few 18 year old children have the financial maturity or sophistication to handle large amounts of money in a judicious manner. The receipt of a large sum could be disastrous to their personal development, initiative, and responsibility. It is also likely that the assets would be imprudently used and invested, causing them to shrink rapidly. As a result, funds might not remain available to help your child as you would have intended.

Addition of Minor's Trust Adds Safeguards

If the will provides for a minor's trust to be established with that child's share, a trustee would control and manage the trust assets on behalf of the child until that child was of sufficient maturity to receive his inheritance outright. Usually, the trustee can provide to the child's physical guardian as much of the trust assets as are needed for health, support, maintenance, and education, until the child reaches age 21. After the child reaches age 21, the trust can provide the child will all or part of the income from the trust and as much additional principal as the child may need for their health,

support, maintenance, and education. The trustee decides how much of the principal is "needed".

Parents Choose Ages of Distribution

With a minor's trust, the parents decide and specify at what ages the child should receive principal distributions from the trust. For example, a child's trust might distribute one-half of the principal at 25 and 30, or one-third at 25, 30 and 35. This is a very personal decision that depends on several individual factors.

INTER VIVOS (LIVING) TRUST

Estate Tax Advantages

As was stated above, if the community estate (including insurance proceeds) is in excess of $1,500,000 there will likely be a federal estate tax due upon the death of the second spouse.

Example: A couple has assets of $1,500,000 and a $100,000 insurance policy. On the insured's death, their estate is worth a total of $1,600,000. There would be no tax on the death of the first spouse if the entire estate is left to the surviving spouse. But on the death of the surviving spouse, the $100,000 in excess of the $1,500,000 exemption will be taxed at a 45% rate and generate a tax of $45,000.

If you reasonably estimate that your estate will equal or exceed $1,500,000 when both spouses pass away, you should seriously consider the use of a "living trust" for estate tax savings alone. A living trust can save estate taxes by allowing you to take advantage of the $1,500,000 estate tax exemption of both spouses, instead of just one. Instead of just using the surviving spouse's exemption, the trust allows you to use another exemption at the death of the first spouse. By doing this, $3,000,000 can be passed on to your beneficiaries without the payment of any estate tax. That represents estate tax savings of $695,000.

The way a living trust works to achieve these savings on a $3,000,000 community property estate is a follows: As much of the deceased spouse's portion of the estate as can be sheltered with that spouse's estate tax exemption (currently $1,500,000) becomes an irrevocable trust, so it is not part of the surviving spouse's estate. The surviving spouse still controls the assets in the irrevocable trust, receives all the income from them, and can access the principal if needed for support. Those assets are also protected from the survivor's creditors. The surviving spouse can then shelter the remaining $1,500,000 in the revocable portion of the trust with their own $1,500,000 exemption.

Estate Tax Law is a Moving Target. The estate tax law is in an unusual stage. The $1,500,000 per person exempt amount is scheduled to increase to $2,000,000 in 2006, and $3,500,000 in 2009. There is no estate tax in 2010, but in 2011, the estate tax returns along with the former $1,000,000 exempt amount. Although this makes precise planning difficult, the living trust remains useful in the estate tax area.

Probate Avoidance.

A very substantial advantage of having a living trust is that you can eliminate the entire probate process through its use. Without the living trust, probate court proceeding are generally necessary at the death of each spouse.

On the death of the first spouse, if all property is going to the surviving spouse and it is all community property, there is a summary probate procedure which is generally not as expensive or as time-consuming as a full statutory probate. The attorney's fees may be less than $2,000. It takes about six months to complete. Executor's fees may also be required.

Sometimes that proceeding can be avoided if property is held in joint tenancy. However, holding property in joint tenancy can cause significant income tax advantages to be lost following a spouse's death. Holding property as “Community Property with Right of Survivorship” allows property to pass to the survivor without probate, but retains the community property tax advantages.

On the death of the surviving spouse, a full probate is generally required. Attorneys and executors fees need to be paid. If the surviving spouse had a gross estate (not counting debt) of $700,000 when they died, attorneys and executors fees would approximate $34,000. A simple probate can take one to two years to complete. A complicated probate can take several years.

This entire expense and delay can be avoided by using a living trust. This involves placing title to your major assets into your names as trustees of your living trust. Holding all one's property as trustees is simply "wearing another hat". It does not eliminate or minimize any rights you have in your property.

For probate purposes, however, the effect of the trust is that when a spouse dies, they don't hold title to any property that needs to be probated. Probate doesn't apply to the assets held in trust. In other words, if a couple dies, but they hold title to all their property as trustees, the court is deprived of its ordinary probate function of assuring that the decedent's property is transferred to the proper heirs. This responsibility becomes the successor trustee's alone. The delay and expense of probate are eliminated.

No Change In Income Tax or Property Tax

The income taxation of the assets transferred to your living trust does not change. You continue to individually report all income, expenses, gains and losses on all property transferred to the living trust. As a matter of fact, the living trust does not file a tax return, since it is not a separate legal entity for income tax purposes. The income tax laws pretend the trust doesn't exist.

Prevents Early Distribution

Another advantage of having a living trust is the ability to keep "strings" on the property in the estate. All of the advantages of adding a minor's trust to a will (discussed above), are also obtained through a living trust. Parents can ensure that their children do not receive full control too early. They can also provide specific directions to the trustee as to what purposes the assets can be used for.

ADDITIONAL ADVANTAGES OF LIVING TRUSTS

Although most people regard the use of a living trust as a means to avoid probate costs and reduce estate taxes, there are several other advantages as well. Some people choose to have a living trust even when their estate is not large enough to be taxed. Here are some other advantages:

1. "Cushion" Against Estate Taxes. Asset accumulation as well as inflation may push an estate into a taxable bracket. For a couple, use of a trust can double the amount exempt from estate taxes.

2. Reduced Capital Gain. Capital gain taxes are often reduced by avoiding the tax disadvantages of inheriting property through joint tenancy. When a person passes away, all of their assets receive a new tax basis equal to their date of death value. This reduces the potential capital gain taxes and provides tax savings through larger depreciation deductions. Community property held in joint tenancy receives a new cost basis on one-half of the property upon the death of a joint tenant. However, community property not held in joint tenancy (such as in the trust, or with right of survivorship) receives a new cost basis on all of the property upon the death of a joint tenant. The income tax advantages of the new cost basis are doubled.

3. Customized Provisions for Children. Ultimate gifts to children or young adults are more satisfactorily arranged by:

   (a) directing that your children's inheritance be held in one lump sum until the youngest child has, for example, attained age 21, and allocate the income and principal among them during this time as individual needs and abilities dictate; and

   (c) permitting distribution of the children's shares to be made in a staggered manner, e.g., one-third at ages 25, 30, and 35.

4. Guardian of Estate Unnecessary. A trust can eliminate the necessity of a court-appointed guardian for the property of minors.

5. Creditor Protection. A trust's "spend thrift provisions" provide protection against a child's creditors, whether arising from business and through his or her own improvidence.

6. Avoid Conservatorships. Conservatorships can be avoided if you suffer a severe injury, disability or senility. A conservatorship is usually similar to a probate in complexity and expense.

7. Unified Plan. A trust assists in simplifying and consolidating your estate plan. Often, a person may mistakenly disinherit a child or other heir, because they do not realize that the provisions of their will may not apply to insurance policies, pension plan assets, IRAs, or property held in joint tenancy. A trust helps to unify your estate plan as to all your assets.

8. Unified Management. Most or even all of your assets can be gathered under one roof, allowing easier management and investment.

9. Privacy. Probate proceedings are public and anyone can obtain a list of the decedent's assets and a copy of their will. Unless there is litigation, the operation of a trust is private. Information about the deceased's assets, liabilities and provisions for his beneficiaries does not automatically become public information.

10. Expensive Accountings Eliminated. A trust eliminates the need for periodic accountings to the court, with a public record of such accountings. Conservatorships and guardianships over assets require such accountings and an extended probate may.

11. Will Contests Avoided. A living trust practically eliminates vulnerability to successful contest by dissatisfied heirs.

12. Business Continuation Facilitated. A trust enables a business held in a living trust to continue operation without the problems presented by probate.

ADDITIONAL OPTIONS

Depending on the size of your estate and your particular family and personal needs, additional methods of estate planning that should be considered are such things as:

1. **A Gifting Program.** By using the annual exclusion of $11,000 per donee (or $22,000 per donee if two spouses join in the gift), a portion of your estate can be eliminated on an annual basis. For instance, by making gifts were made to four children, a couple could remove up to $88,000 per year from their estate with absolutely no federal gift tax due whatsoever. A federal gift tax return would not even have to be filed. If a person were to die with $88,000 in their estate, beyond the $1,500,000 exemption, the estate tax would be approximately $39,600. Therefore, one year's gifting saved $39,600. If structured correctly, these gifts can be made into a trust for the children's future benefit. That is an excellent way to remove life insurance from the taxable estate.

2. **Other Alternatives.** There is a wide variety of alternatives, beyond those discussed above, including the use of life insurance, the use of charitable trusts, or charitable giving.

This is only a skeletal presentation of basic types of estate plans. The advantages and disadvantages of certain of these estate plans should be discussed in order for you to properly evaluate your options and decide on the estate plan most suited to your personal and business needs. After you have had an opportunity to review this memo, please contact me so that we may discuss how you wish to proceed.

Yours very truly,

MICHAEL R. BROWN,
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Michael R. Brown