

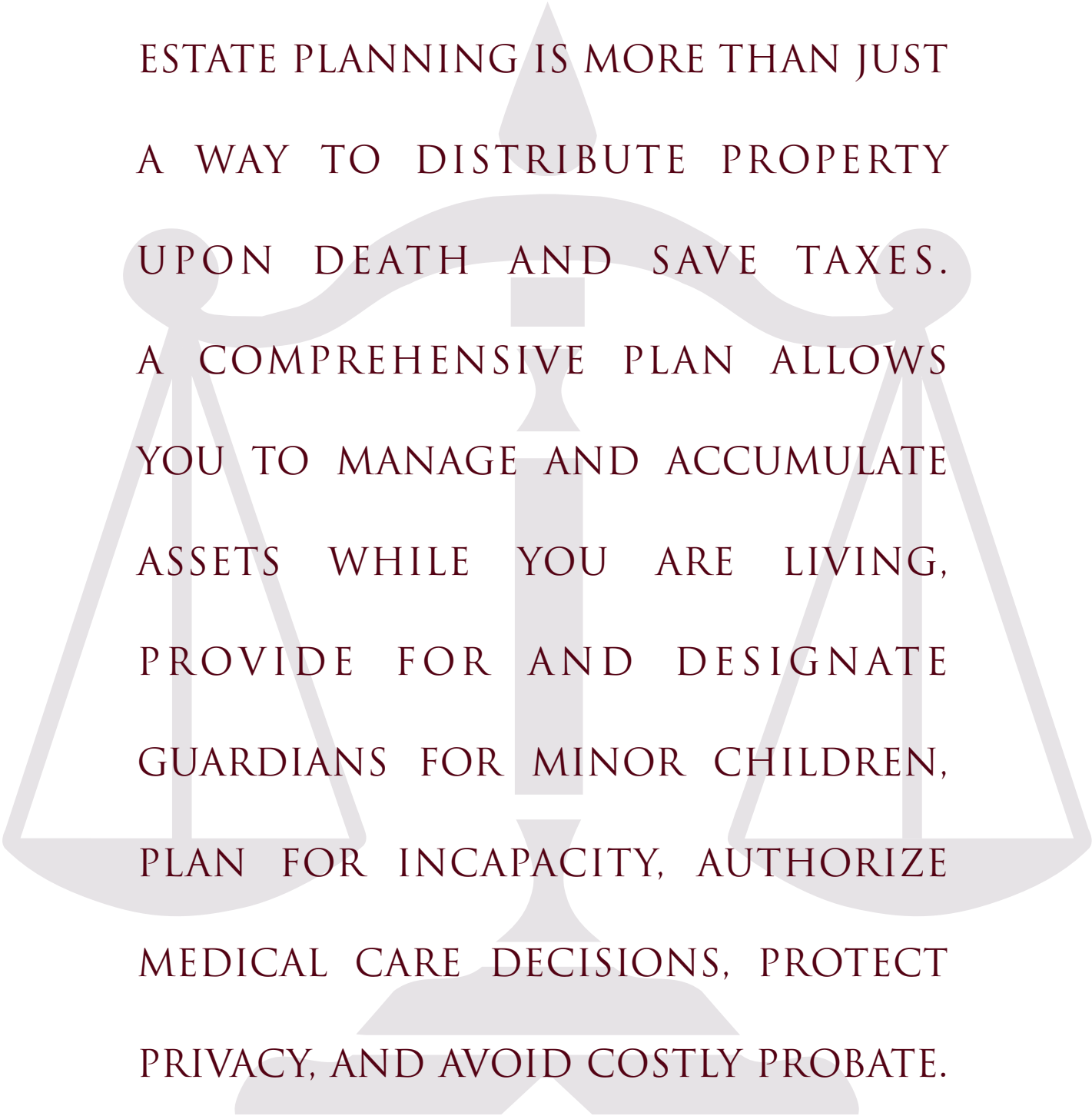


# ESTATE PLANNING

*Your loved ones, your future.*



SANDERS & MONTALTO, LLP  
ATTORNEYS AT LAW



ESTATE PLANNING IS MORE THAN JUST  
A WAY TO DISTRIBUTE PROPERTY  
UPON DEATH AND SAVE TAXES.  
A COMPREHENSIVE PLAN ALLOWS  
YOU TO MANAGE AND ACCUMULATE  
ASSETS WHILE YOU ARE LIVING,  
PROVIDE FOR AND DESIGNATE  
GUARDIANS FOR MINOR CHILDREN,  
PLAN FOR INCAPACITY, AUTHORIZE  
MEDICAL CARE DECISIONS, PROTECT  
PRIVACY, AND AVOID COSTLY PROBATE.

**E**state planning is the process of accumulating, managing, and disposing of your property to maximize the goals of the estate owner. The various goals of estate planning include making sure the greatest amount of the owner's property passes to the owner's intended beneficiaries, paying the least amount of taxes, avoiding steep probate and executor fees, and preventing years of probate court involvement. Additional goals include providing for and designating guardians for minor children, planning for incapacity, authorizing medical care decisions, protecting privacy, and protection against creditor claims.

On the personal side, a good estate plan includes directions to carry out your wishes regarding health care matters, so that if you ever are unable to make medical decisions yourself, someone you select would do that for you according to the guidelines you set, including authorizing heroic measures and other end-of-life decisions.

Estate planning ensures that your property is properly managed, accumulated, and distributed upon your death with maximum ease and minimal costs, delays, and problems. Additionally, estate planning allows you to provide for and designate guardians for minor children, plan for incapacity, authorize medical care decisions, protect privacy, and minimize or eliminate creditor claims. With proper planning you can minimize or totally eliminate estate taxes, probate fees, and court costs. Poor planning results in unnecessary taxes, fees, costs, and judicial involvement which can increase anxiety and stress to you and your family.

If you have a Will, probate will be required. This is a time consuming process, and requires approximately one to three years or more (depending on the complications in the estate) before your property is distributed. Moreover, probate results in substantial attorney's fees, executor fees, and administrative costs.

Probate fees are calculated as a percentage of the "gross value" of your estate whether your assets are worth

\$100,000 or \$5,000,000. A complete discussion and table of probate fees is provided later. A Living Trust avoids all probate fees. If you have a Will there is little that can be done to minimize or eliminate estate taxes. A Living Trust can be set-up to substantially minimize or avoid all estate taxes. A complete discussion and table of estate taxes will be discussed below.

A Living Trust (sometimes referred to as an inter vivos trust) is a legal document that allows you to give your property to your beneficiaries just like a Will. However, a Living Trust, unlike a Will, avoids probate, the delays in transferring property, involvement with the legal system, attorney's fees, executor fees, probate fees, and other costs. By use of a Living Trust, the disposition and transfer of property may be arranged within hours rather than years.

A Living Trust is also harder to challenge than a Will. Therefore, it provides a level of security against potential

## WHAT IS AN ESTATE?

The term "estate" consists of all the property a person owns or controls, whether in his or her sole name, held in a partnership, in a joint ownership arrangement, or through a trust, and all other monies that would be generated on the person's death, such as through life insurance. It includes:

- (1) real property and things attached to it (houses, buildings, barns, etc.)
- (2) all personal property (including automobiles, bank accounts, stocks and bonds, mutual funds, stock options, cash, furniture, jewelry, art, collectibles, etc.)
- (3) all businesses and business interests (sole proprietorships, partnerships, corporations, joint ventures, and the goodwill, inventory, tools and equipment, accounts receivable, and other business property, etc.)
- (4) powers of appointment (the right to direct who gets someone else's property)
- (5) life insurance and annuity contracts, pension benefits, IRAs, 403(b)s, etc.
- (6) all debts and obligations; and
- (7) all claims you have against others, such as for the pain and suffering from an auto accident.

challenges by disinherited relatives. Since a Living Trust usually will have been in place for a considerable period of time before the death of the Trustor, and since there is no court proceeding initiated to determine the validity of the trust document, it becomes much more difficult for disinherited relatives to successfully challenge the estate plan.

A Living Trust is also private, and therefore protects the private details of your life and financial affairs from public disclosure. A Will on the other hand, must be probated with the court which provides a transparent public proceeding where the private details of your life and affairs are disclosed to the public.

A Living Trust is particularly advantageous where the Trustor owns real estate in more than one state, since separate ancillary probate proceedings may be required in each state where real property is located. As a result, probate fees soar even higher.

A Living Trust can also be drafted to provide for management of assets during any period of illness or incapacity of the Trustor. This flexibility will normally avoid the necessity of expensive conservatorship proceedings in the future, and will provide the smooth transition of control from the Trustor to a trusted, selected individual or entity.

In a Living Trust, it is possible for the Trustee to hold assets which will be used for support, maintenance and

education of young children or others who need to be protected. If properly set-up, it avoids the necessity of expensive and protracted judicial intervention.

A Living Trust can be set-up to distribute assets to your children directly so that should a spouse remarry, there is no danger that the decedent's assets will go to the new spouse and the spouse's family instead of the Trustor's children.

As a part of estate planning in larger estates, one should consider devising a gift program. It is possible to make annual gifts to reduce a person's taxable estate. There is an annual gift tax exemption of \$12,000, or the current exemption amount, per person per year. For example, in the estate plan for a married couple, it is possible to gift \$24,000 per child per year without any gift or estate taxes. If the gift program utilizes a "Crummey" Trust the money will be held in a trust and cannot be touched by your children until death. Further, placing funds in a "Crummey" Trust protects that property against creditor claims, and avoids probate like other trusts.

Another popular subcategory of a Living Trust is the Charitable Remainder Trust ("CRT"). The CRT may permit the Trustor to covert highly appreciated assets into higher-yield holdings, thereby improving the Trustor's income flow, while avoiding tax on capital gains generated by the sale.

# ESTATE PLANNING DOCUMENTS

Several of the following documents are typically used as part of the estate planning process:

**WILL.** A Will, sometimes called a “Last Will and Testament”, is used to distribute property you own at your death to the person(s) and/or organization(s) you want to have it. A Will also names someone you select to be your Personal Representative (or “Executor”) to carry out your instructions. A Will only becomes effective upon your death, and must be probated with the court, and subject to executor fees, legal fees, and potentially unnecessary taxes. Probate also is a very long process taking 1-3 years to complete.

**LIVING TRUST.** A “Living Trust” is used to hold your property and provide a mechanism to manage and distribute property during your life and upon your death. You can select the person or persons you want — often even yourself — as the Trustee(s) to carry out the instructions you want in the Trust and name one or more Successor Trustees to take over if you cannot. Unlike a Will, a Trust usually becomes effective immediately, continues in force during your lifetime even in the event of your incapacity, and continues after your death. Most Trusts are “revocable” which allows the person who creates the Trust to make future changes, modifications and even to terminate it. (If the Trust is “irrevocable”, changes, modifications and termination are very difficult (and sometime impossible), although such Trusts often carry some tax benefits.) Trusts also allow you to avoid or minimize the expenses, delays and publicity of probate.

**ADVANCED HEALTH CARE DIRECTIVE.** An “Advanced Health Care Directive” allows you to appoint a person or persons to make health care decisions for you in the event you cannot such as in the case of your permanent incapacity; for example an irreversible coma or persistent vegetative state. A health care directive also provides your stated wishes and instructions regarding the nature and extent of the care you want should you suffer permanent incapacity as well as end of life decisions. A health care directive also allows one to provide other wishes as it pertains to making anatomical gifts, donating parts of your body, authorizing an autopsy, and specifying burial or cremation arrangements.

**LIVING WILL.** A “Living Will” or “Directive to Physicians” is an advance directive which gives doctors and hospitals your instructions regarding the nature and extent of the care you want should you suffer permanent incapacity, such as an irreversible coma. The Living Will is an inferior document to the Advanced Health Care Directive which allows greater flexibility and powers.

**DURABLE POWER OF ATTORNEY FOR ASSETS.** A “Durable Power of Attorney for Assets” allows you to appoint a person or persons to act for you and handle financial matters should you be unable or perhaps unavailable to do so. These powers can be immediate, or “springing” by allowing a person or persons to act for you in financial matters such as when two licensed physicians state you are mentally incapable of doing so.

**NOMINATION OF GUARDIANSHIP.** A “Nomination of Guardianship” document is a comprehensive document that allows you to nominate individuals to serve as the guardian of your minor children. The guardian can be nominated to handle the personal care of your minor children or the assets you leave for your minor children or both. In the Guardianship document you can also provide a comprehensive plan as to how you would like your children raised, specific instructions concerning health insurance for your minor children, issues of moving out of state, religion, contact with other family members, et cetera.

**P**robate is the legal process with the court by which your property is transferred from your estate to your beneficiaries upon your death. Since you can't take it with you, the court determines who gets it.

If you die with a Will ("testate"), the probate court determines if the Will is valid, hears any objections to the Will, orders that creditors be paid and supervises the process to assure that property remaining is distributed in accordance with the terms and conditions of the Will.

STATUTORY PROBATE & EXECUTOR FEES	
GROSS VALUE OF ESTATE	ATTORNEY & EXECUTOR FEES
\$200,000	\$14,000
\$300,000	\$18,000
\$400,000	\$22,000
\$500,000	\$26,000
\$600,000	\$30,000
\$700,000	\$34,000
\$800,000	\$38,000
\$900,000	\$42,000
\$1,000,000	\$46,000
\$2,000,000	\$66,000
\$4,000,000	\$106,000

The fees listed above are the California statutory fees used to compensate attorneys and executors in probate cases based on the gross value of the estate. They do not include extra-ordinary fees and costs routinely charged when dealing with real estate, creditor claims, and other common estate charges.

If you die without a Will ("intestate"), the probate court appoints a person to receive all claims against the estate, pay creditors and then distribute all remaining property in accordance with the laws of the state. The major difference between dying testate and dying intestate is that an intestate estate is distributed to beneficiaries in accordance with the distribution plan established by state law which may differ considerably from what you want; a

testate estate (after payment of debts, taxes and costs of administration) is distributed in accordance with the instructions you provided in your Will.

The cost of probate is set by state law. Above is a schedule of charges and costs to probate an estate in California. The probate and executor fees are calculated as a percentage of the gross value of your property. Gross value is the total value before deduction of any debts or liabilities. This means if you own a home worth \$500,000 and carry a mortgage of \$400,000 you are charged a percentage of \$500,000 which could completely wipe out the net value (\$100,000) of the home.

Probate is also a public proceeding where private details of your life and property are disclosed to the public.

### HOW CAN AN ESTATE PLAN AVOID PROBATE?

An estate plan uses several tools to prevent a court from gaining jurisdiction over your estate in the event of your death. The Durable Power of Attorney for Property enables your attorney-in-fact to handle your financial affairs and make last minute arrangements should your death be imminent. A common technique used by your attorney-in-fact, who is often your Successor Trustee as well, is to transfer property which is not currently held in your Trust into the Trust, so legal title to the property is held by the Trust at the time of your death. Property placed in your Trust is not part of your estate at the time of your death. The instructions for the management and distribution of your property are set forth in the Trust, and carried out by your Successor Trustees in the event of your incapacity or death; there is no need to have the court grant authority to someone. By getting a Trust in place and transferring ownership of particular properties to it, you avoid the need to get a court involved with a Conservatorship in the event of your incapacity, or probate in the event of your death. A well coordinated estate plan can help you maintain a semblance of control over your property even after your death.

**E**state taxes are taxes calculated against the net value of your estate. These taxes are in addition to probate and executor fees covered in the preceding section. Unlike probate and executor fees, estate taxes are charged as a percentage of the net value of your estate. Below is a schedule of projected estate taxes on various size estates as of 2006, 2007 and 2008.

**HOW CAN AN ESTATE PLAN AVOID OR MINIMIZE ESTATE TAXES?**

Everyone gets a “credit” against Federal Estate Taxes on an exemption amount of \$2 million in 2006, 2007 and 2008 (Unless previously used up, in whole or in part, as a result of gifts of more than \$12,000 to any person in any year starting in 2006). Individuals and married couples with a total estate value less than the current exemption level don’t have to worry about Federal Estate or Gift Tax (the exemption amount slowly increases in steps to \$3.5 in the year 2009 but then drops back to \$1 million when the estate tax is reinstated in 2011).

For those who are married, there is an unlimited marital deduction. All estate taxes can be avoided upon the death of the first spouse to die. However, the surviving spouse would have to remarry and give his/her entire estate to the new spouse in order to get another unlimited marital deduction. Most people would rather their children or other relatives benefit from the estate than a new spouse and his/her family.

An estate plan can take advantage of certain tax avoidance techniques for those who have accumulated some wealth; this gets more of your property to your intended beneficiaries and less to the federal government.

**DID YOU KNOW?**

Your Life Insurance benefits are added to the net value of your estate and taxed.

Substantial tax savings can be achieved by using a By-pass Trust at your death to hold property for your children while enabling it to provide for your surviving spouse during his/her lifetime. This allows you to place up to \$2,000,000 (or the current exemption amount) in a Trust for the benefit of your surviving spouse and children which will not be subject to estate tax upon the death of your surviving spouse. Coupled with your surviving spouse’s estate and gift tax credit, this enables your spouse and you to send up to \$4,000,000 (or the applicable exemption level in that calendar year) to your children free from Federal Estate and Gift Tax which would translate into a huge tax savings.

Additionally, by utilizing Irrevocable Life Insurance Trusts and/or devising a gift program employing other “Crummey” Trusts, it is possible to save hundreds of thousands more in estate taxes.

PROJECTED ESTATE TAXES	
VALUE OF ESTATE (NET)	FEDERAL ESTATE TAX
\$2,500,000	\$230,000
\$3,000,000	\$460,000
\$3,500,000	\$690,000
\$4,000,000	\$920,000
\$4,500,000	\$1,150,000
\$5,000,000	\$1,380,000
\$6,000,000	\$1,840,000
\$7,000,000	\$2,300,000
\$8,000,000	\$2,760,000
\$9,000,000	\$3,220,000
\$10,000,000	\$3,680,000

## LIVING TRUST

A Living Trust, or intervivos trust, is any trust that is created while you are "living". A Living Trust may be revocable or irrevocable. A Living Trust may be simple or complex, such as a tax saving "By-pass" or "Q-Tip" trust.

A Living Trust is designed to hold and manage your property during your lifetime, and to provide a mechanism to distribute your property upon your death. In a Living Trust, you select the person or persons you want -- often yourself -- to serve as Trustee to carry out the instructions you want in the Trust. You also select the person or persons you want to serve as the Successor Trustee in the event you (or somebody else) cannot act as Trustee, such as upon your incapacity or death.

Unlike a Will, a Living Trust becomes effective immediately, continues in force during your lifetime (even in the event of your incapacity), and continues after your death. A Living Trust allows you to avoid the expenses, delays, and publicity of probate. A Living Trust also allows you to avoid the uncertainty and expense of conservatorship proceedings should you become incapacitated during your life.

Most Living Trusts are "revocable" which allows the person who creates the Trust to make future changes, modifications and even terminate it. If the trust is "irrevocable" changes, modifications and termination are very difficult and sometimes impossible, although there are valuable tax advantages with irrevocable trusts.

## BYPASS TRUST

A bypass trust is the same as a Living Trust except that it provides greater estate tax savings. A bypass trust is particularly useful for spouses who plan their estates together. By leaving property to each other in bypass trust form, they can guarantee that the property will only be taxed once between the two of them. Each person can pass \$2,000,000 (the exclusionary amount in 2006) free of estate taxes. However, in a Living Trust when the first spouse dies all of the property typically passes to the surviving spouse. Then, when the surviving spouse dies the property is typically passed to children or other family members and friends. As a result, the first spouse to die did not use his or her \$2,000,000 exclusionary amount and when the second spouse dies they can only exclude their own \$2,000,000 exclusionary amount. A bypass trust is set-up to utilize both spouses' exclusionary amounts so that they can pass up to \$4,000,000 without paying any estate taxes.

To effectively save taxes, a bypass trust must follow certain rules laid out by the IRS. Let's suppose you set up a bypass trust, and you die first. In order to keep the trust from being subject to estate tax when your spouse dies, the following conditions must be placed on the trust:

- **YOU MUST LIMIT YOUR SPOUSES' POWER TO ACCESS THE TRUST DURING THEIR LIFETIME.**

Your spouse cannot have an unrestricted right to withdraw principal on a portion of the trust assets. However, they may have the unrestricted right to withdraw principal to provide for health, education, maintenance, or support, in any amount up to the whole of the trust estate, and they may also have the right to withdraw up to \$5,000 of principal per year for any purpose, or 5% of the total principal, whichever is greater.

You can also give your spouse the unrestricted right to all income from the trust property (e.g., interest, dividends, etc.), and you can appoint your spouse as trustee. As trustee, they would have full discretion to decide whether principal is needed for their "maintenance" or "support." Thus, this condition is ultimately quite flexible.

- **YOU MUST LIMIT YOUR SPOUSE'S POWER TO DISTRIBUTE TRUST ASSETS UPON THEIR DEATH.**

Except as provided above, your spouse cannot have the right to give the trust assets in a portion of the trust to themselves, their creditors, their estate, or their estate's creditors. You may, however, give your spouse the right to name in their will specific persons who will succeed to the trust upon their death. For example, you could authorize your spouse to leave the trust to any of your nieces and nephews, or to divide it as they please among your children. Alternately, you can specify who gets the trust next and leave your spouse no discretion.

Although a bypass trust can be very flexible in practice, **it is critical that the trust be drafted with absolute precision.** The IRS has specified the words that may be used in a bypass trust, and if these words aren't duplicated perfectly, the trust might not be excluded from tax in the second estate. Even the slightest drafting error can cost hundreds of thousands of dollars in taxes, so be sure your bypass trust is being drafted by an attorney who is knowledgeable about federal tax law.

## LIFE INSURANCE TRUST

A life insurance trust is a trust that is set up for the purpose of owning a life insurance policy. If the insured is the owner of the policy, the proceeds of the policy will be subject to estate tax. But if the insured transfers ownership to a life insurance trust, the proceeds will be completely free of estate tax. (The proceeds will be exempt from income tax either way.)

Given the current estate tax rate of 46%, a life insurance trust can save hundreds of thousands of dollars in estate taxes. However, there are several drawbacks to such an arrangement:

- **YOU CAN'T CHANGE THE BENEFICIARY.**

The insured must give up the right to change the beneficiary of the policy (the trust itself will be the beneficiary). The trustee alone has that right, and the insured cannot serve as trustee of their own life insurance trust. Of course, the insured will designate the beneficiaries of the trust (for example, their children). But because this designation cannot be changed after the life insurance trust has been set up, the insured will lack the flexibility to deal with changed family circumstances with this particular policy.

- **YOU CAN'T BORROW FROM THE POLICY.**

The insured can no longer borrow against the policy. If the trust allows the insured to borrow against the policy, they will be deemed to be an owner of the policy for estate tax purposes.

- **YOU CAN'T TRANSFER AN EXISTING POLICY TO THE TRUST – UNLESS YOU LIVE FOR AT LEAST 3 MORE YEARS.**

If the insured transfers an existing policy to a life insurance trust and dies within the next three years, they will be treated as the owner of the policy and it will be taxed in their estate. Even if the insured survives another three years, they will have made a taxable gift in the amount of the cash value of the policy (of course, this is usually preferable to having the entire face value subjected to estate taxes). If the life insurance trust takes out a new policy on the insured's life, however, the insured will never be deemed to own the policy. Furthermore, no cash value will have built up yet, so no taxable gift will be made.

- **THE LIFE INSURANCE TRUST MUST BE IRREVOCABLE.**

Once you set up and fund the trust, you cannot get the policy back. If you become uninsurable, you will be committed to this trust as your only life insurance.

- **PREMIUM PAYMENTS MAY USE UP YOUR ESTATE TAX EXEMPTION.**

If the policy has not yet ended, you must find a way to pay the premiums without using up your estate and gift tax exemption. If you transfer securities to the trust so that the trustee will have income with which to pay the premiums, the full value of the securities will be a taxable gift. If you transfer cash to the trust each year to pay the premiums, each transfer will be a taxable gift. However, you may be able to exempt these premium payments from gift or estate taxes by setting the life insurance trust up as a Crummey Trust. Then each premium payment can be sheltered by your annual gift tax exclusion, which is \$12,000 (indexed for inflation) per trust beneficiary.

- **YOU MUST FIND OR HIRE A TRUSTEE.**

The insured cannot serve as trustee of the life insurance trust. That means that he will have to find or hire a third party trustee. However, many banks and trust companies offer reduced fees because they involve little investing decisions.

Despite these drawbacks, many people find that the tax saving potential of a life insurance trust is worth the cost and hassle. It allows you to remove from your estate a significant asset that you are unlikely to want access to during your life. And it ensures that the life insurance proceeds go 100% to the beneficiaries, not the federal government.

## CRUMMEY TRUST

Many people wish to make lifetime gifts to their children in order to save estate taxes. As long as a parent gives their child no more than \$12,000 per year, the gifts will be entirely excluded from gift or estate taxes. (That \$12,000 limit increases regularly with inflation.)

The problem with gifts so large is that children do not have the legal capacity, or in many cases the maturity, necessary to handle so much money. You can solve the issue of legal capacity by appointing yourself as custodian of the funds you have given your child (such as by making the gift subject to the Uniform Transfers to Minors Act), but under a custodial arrangement, the child obtains access to all of the money upon turning 21, or in some states 18. To many parents, this is still too young.

To keep the money out of a child's hands until they are, say, 28 years old, you must set up a formal trust. You would then make your gifts to the trust, and the trustee would

invest the money. To conserve costs, you could even serve as trustee yourself. The trust documents would direct that the assets be distributed to the child when the child reaches age 28. Some people have the trust distribute the funds in steps: the child receives one-third when they turn 25, one-third when they turn 30, and the final third when they turn 35.

The one catch to all of this is that the \$12,000 annual exclusion only applies to gifts in which the recipient has a “present interest” in the gift (as opposed to a “future interest”). In order to completely avoid gift or estate tax on the money you give to the child’s trust, you must give the child some right that qualifies as a “present interest.”

What qualifies as a present interest? Generally, the child has to have the right to take the money and spend it immediately. However, you can place significant restrictions on this right without losing the gift tax exclusion. A common method of doing so is to set up what is known as a Crummey Trust. It’s named after the Crummey family, who set up such a trust. The IRS tried to deny them the annual gift tax exclusion, but they went to court and won.

A Crummey Trust does not give the child any rights to the income. It does, however, give the child the right to withdraw the amount of each gift for up to 30 days after each gift is made. Since the withdrawal right begins immediately after the gift is made, it is considered a present interest. If the child does not withdraw the gift within the 30 days, the withdrawal right lapses and the money remains in the trust until the child reaches the designated distribution age.

Of course, the parent must still convince the child not to withdraw the money during those 30 days. However, even if the child decides to withdraw the money, they can only withdraw the amount of the most recent gift, not the entire trust. And after that the parent can eliminate all future withdrawal opportunities simply by ceasing to make any more gifts. The property in the trust will still remain intact and growing until it’s ready to be distributed.

## **SPECIAL NEEDS TRUST**

A Special Needs Trust allows a parent, grandparent or guardian to provide funds for a disabled child without disrupting the child’s eligibility for government aid. If your family is caring for a child with disabilities, you may not be aware of options that would allow you to use funds from your child’s inheritance or personal injury settlement / award to help your family provide care and enhance quality of life for your child now, while maintaining his or her eligibility for Medicaid at a later date.

# A D D I T I O N A L C O N C E R N S

## CONSERVATORSHIP

If you suffer from an incurable disease or are involved in a debilitating accident and are unable to manage your own affairs, state law might require someone to go to court to have a conservator appointed by the court. The conservator is given the authority to make financial decisions and handle your financial affairs, under court supervision, when you lack the capacity to manage them on your own.

The conservator has to make periodic reports to the court and petition the court for additional authority under certain circumstances. Typically, the conservator may be paid for services rendered on your behalf and there will be attorney fees as well. In addition, the court will often require your conservator to purchase a “surety bond” which is a type of insurance policy, to protect the conservatorship estate. The costs and expenses of a conservatorship are paid by your estate.

## HOW CAN AN ESTATE PLAN AVOID A CONSERVATORSHIP?

An estate plan uses several tools which can prevent the court from gaining jurisdiction over your affairs. A Living Will or Directive to Physicians is used to determine if artificial life support systems are to be used or withheld.

A Durable Power of Attorney for Health Care is used to provide authority to a person, in whom you have the utmost trust and confidence, to make decisions regarding health care treatment when you are unable to provide informed consent.

A Durable Power of Attorney for Property enables you to authorize a person to act in your place and stead in the event of your incapacity; this attorney-in-fact can manage your financial affairs without the need to have intervention by the courts.

A Trust is used to hold property; the Trustees manage the property held just like you would if you were not incapacitated.

Thus, a properly prepared estate plan can enable you to avoid a Conservatorship proceeding over your estate. Compared to the cost of a Conservatorship proceeding, an estate plan can be very attractive.

## WHAT IS ELDER CARE PLANNING?

Elder law deals with the legal, financial, and health needs of senior citizens. The country’s average age is advancing all the time, and now even baby-boomers are dealing with health issues and legal concerns they had not anticipated. Estate planning is part of the elder law field, but elder law lawyers also help with preparing for long-term health care needs, applying for government programs, addressing financial fraud, and combating physical abuse of the elderly. Attorneys can also assist in establishing guardianships and conservatorships when needed. A competent and experienced estate planning lawyer should be consulted on these issues.

### **HEALTH CONCERNS, MEDICARE, MEDICAID, & NURSING HOMES.**

When nursing home care is needed, Medicare is of only marginal assistance. Medicare covers the first 20 days and a portion of the next 80 days of care in a nursing home as long as you are receiving treatment and you are improving. Long-term health care and extended time in a home is not covered by Medicare. The only government program that will pay for long-term care is Medicaid, which is designed to help low income people with medical bills. Medicaid will cover long-term care costs for qualified people and it will even cover some costs left over from Medicare. Unless an individual is impoverished, the assets accumulated over a lifetime can be wiped out by a nursing home stay.

To avoid this occurrence, an estate plan can give away an elderly person’s assets over time for the purpose of qualifying for the Medicaid program. The goal is to reduce the assets below the minimum amount for Medicaid. This strategy prevents an elderly person’s assets from being used up to pay for uninsured health care expenses or nursing home costs, and allows the assets to be transferred to children or other family members.

Medicaid rules prevent a person from receiving benefits by transferring assets right before going into a nursing home. A skilled estate planning attorney can plan ahead for residential care needs and minimize the financial impact on an elderly person’s estate. It is certainly advisable for people to prepare for these issues prior to becoming senior citizens, but it is never too late to take control.

# P O S T - D E A T H T A X R E T U R N S

## FEDERAL ESTATE TAX (FORM 706)

A Federal Estate Tax Return (Form 706) must be filed for the estate of each decedent whose “gross estate” exceeds \$2,000,000 (for 2006). A decedent’s “gross estate” consists of all property that the decedent owned or had an interest in as of the date of death, including real estate, joint interests, life insurance, personal property, annuities, and property subject to the decedent’s power of appointment.

After calculating the gross estate, the estate may deduct funeral expenses, debts of the decedent, administration expenses (including attorney and executor fees), qualified charitable gifts and qualified bequests to a surviving spouse (“marital deduction”). The marital deduction is unlimited, meaning that you can leave \$1,000,000,000 (or more) all to your surviving spouse without paying a penny of estate tax (until your surviving spouse dies, of course). This is good news for married couples, but also presents a trap that many fall into by failing to utilize each spouse’s “unified credit” (described below).

After calculating the gross estate and subtracting deductions, there are several credits that the estate will use. The first is the “unified credit” also known as the “exemption equivalent.” This is currently (in 2006) the \$2,000,000 threshold that I mentioned above - meaning that the first \$2,000,000 is not subject to estate tax.

The Credit for Tax on Prior Transfers comes into play when your estate includes assets that you received by inheritance from an estate that paid estate taxes. The previous transferor must have died within 10 years of your date of death and the credit ranges from 20% to 100%.

The estate tax return also includes the generation-skipping transfer tax. In a nutshell, this is only applicable if your estate gifts more than \$2,000,000 to a “skip person” (e.g. grandchildren, others more than 37.5 years younger).

Additionally, many states now have their own separate estate tax requirements. Some require filing and payments with an exemption that is less than the federal exemption. State estate tax applies in the decedent’s state of residence as well as in each state where the decedent owned real property.

The above only scratches the surface of issues that may arise in preparing estate tax returns. Proper post-mortem estate tax planning and preparation can help save significant tax liabilities in many instances.

## FIDUCIARY TAX (FORM 1041)

After an individual’s death, but before distribution to a beneficiary, either the decedent’s estate or trust may earn on income on its assets. If so, that estate or trust itself becomes a taxpayer that must apply for and receive a Tax ID#, and file applicable income tax returns.

However, fiduciary income tax returns are quite different from individual income returns. The marginal rates are far more compressed and it reaches the highest marginal rate at less than \$9,000. Further, there are deductions and credits that are unique to fiduciary returns.

## FEDERAL INCOME TAX (FORM 1040)

The estate’s fiduciary must also file the decedent’s final 1040 showing all income earned up to the decedent’s date of death. This return should be prepared in conjunction with any 1041’s and the 706 so as to bifurcate the taxable year and allocate deductions between the entities.

**BASIS OF PROPERTY.** The value used to determine gain or loss for income tax purposes. The basis may be cost or a different amount, depending on the law affecting the transaction.

**BENEFICIARY.** The individual or corporation who receives the benefit of a transaction, e.g., beneficiary of a life insurance policy, beneficiary of a trust, beneficiary under a will.

**CODICIL.** An addition to a will that may modify, add to, or subtract from, qualify, alter, or revoke provisions in the will. The codicil is a separate document. It is signed with the same formalities as a will. The codicil can be changed, revoked, canceled, or destroyed at any time.

**COMMUNITY PROPERTY.** Real or personal property that is owned in common by husband and wife as a kind of marital partnership. Either spouse has management and control of the community real and personal property; however, both spouses must join in a transfer of ownership or lease for more than one year of community real property. All property acquired during marriage from earnings, and the earnings themselves, are community property. Property acquired prior to the marriage, or during the marriage by gift or inheritance is not community property. Spouses can by oral or written agreement change the character of the property from separate to community property and vice versa.

**CORPUS.** Term referring all property belonging to a trust.

**DONOR.** One who makes a gift. The recipient of that gift is referred to as the donee.

**EQUIVALENT EXEMPTION.** A unified tax credit is deducted from any estate tax owed. This credit is the tax equivalent to the deduction from the gross estate of an amount called the equivalent exemption. For 2005, 2007, and 2008, the equivalent exemption is equal to \$2,000,000. The equivalent exemption amount slowly increases in steps to \$3.5 million in the year 2009 but then drops back to \$1 million when the estate tax is reinstated in 2011.

**ESTATE TAXES (FEDERAL).** The death taxes imposed by the federal government on the transfer of assets on death. The taxes are generally paid by the executor of the estate.

**EXECUTOR.** The individual or corporation appointed in a will by a testator (one who makes a will) to take care of the testator's property after death. Also called a personal representative. The executor is confirmed by the probate court. He has the legal and business responsibilities and functions under the jurisdiction of the probate court. The executor chooses the attorney to do the legal work for the estate. Executrix is the term for the female executor,

although executor is now used for both male and female personal representatives in probate.

**FIDUCIARY.** A person charged with the duty of carrying out the terms of a trust on behalf of a beneficiary. Executors and trustees are fiduciaries.

**FUTURE INTEREST-GIFT TAX.** A gift by a donor to a recipient, the donee, whereby the donee receives the benefit, use, or enjoyment sometime in the future. Such a gift cannot take advantage of the \$12,000 annual exclusion, which is reserved for the gift of a present interest. If a parent give a child \$10,000, and the child cannot use it now but must use it in the future, that is a gift of a future interest.

**GENERATION-SKIPPING TAX.** The death or lifetime transfer tax imposed on a taxable distribution from, or a taxable termination of, a generation-skipping trust which is defined as a trust with two or more generations of beneficiaries belonging to a younger generation than the grantor.

**GIFT TAX ANNUAL EXCLUSION.** The federal government allows the donor to exclude \$12,000 of a gift from gift tax liability of a gift that is a present interest to a specific individual donee. A present interest gift is one of which the donee has an immediate unrestricted right of use, benefit, and enjoyment. If a parent gives a child \$10,000, and the child can use it now, that is a gift of a present interest.

**GRANTOR.** The individual or corporation who makes a grant of property to another person, e.g. grantor of a trust, grantor of a deed of property.

**GROSS UP RULE FOR GIFT TAX.** The amount of gift tax paid on gifts made within three years of death is included in a decedent's gross estate. This "gross up" rule eliminates any incentive to make deathbed transfers to remove an amount equal to the gift taxes from the assets of the decedent.

**GUARDIAN.** The individual (or corporation) who legally has the care and management of the person, property, or both of an unmarried child during his or her minority. In California, minority now ends at age 18. A guardian also may have authority over the property of a married minor. A conservator is a person who may be appointed to care for the person or property or both of an incompetent adult, or for the person of a married minor.

**HEIR.** The person who inherits property under state law.

**INHERITANCE TAXES.** The California taxes imposed on the transfer of property of decedents who died before 8:00 p.m., June 8, 1982. California inheritance taxes were

repealed by the passage of Proposition 5 and 6 in the June 8, 1982, election. However, federal inheritance taxes (estate taxes) are not repealed and remain in effect today.

**INTER VIVOS TRUST (LIVING TRUST).** A trust created between living people. The grantor, referred to as trustor or settlor, is a living person or existing corporation. Compare this to a testamentary trust.

**IRREVOCABLE TRUST.** A trust the terms and provisions of which ordinarily cannot be changed, modified, altered, amended, or revoked. Under certain circumstances, a court may make limited changes.

**ISSUE.** Generally, progeny, offspring, lineal descendants (children, grandchildren, etc.), and adopted children. However, a testator can, in his will, define issue to exclude adopted children.

**JOINT TENANCY.** A form of property ownership by two or more person designated as “joint tenants with right of survivorship.” When a joint tenant dies, his interest in the property automatically goes to the surviving joint tenant outside of an beyond the power of the will of the deceased joint tenant; the property passes outside probate. But holding property in joint tenancy has dangers, including certain tax disadvantages. Consult your attorney before taking title to property in joint tenancy.

**LIFE ESTATE.** An interest in property, the term of which is measured by the life of the person holding the interest.

**LIFE TENANT.** The person who receives the benefits from real or personal property during his lifetime only. The benefits stop when he dies. The benefits are rents, income, and possibly the use of the property. The life tenant is not necessarily the “tenant” occupying the property, such as a lessee or renter.

**MARITAL DEDUCTION.** In estate and gift taxation, the amount of property one spouse can give to the other spouse outright or in a special trust without estate or gift taxation. For decedents dying after 1981, 100 percent of property, whether community or separate, passed to a spouse is considered a marital deduction in computing the transfer taxes. Therefore, the marital deduction is considered unlimited.

**MINOR.** A person under the age of legal competence. In California, the age is 18.

**PERPETUITIES, RULE AGAINST.** An extremely complicated rule the purpose of which is to keep property from being frozen in a trust beyond a certain period of years. If the trust violates the rule against perpetuities, it is void from its beginning. The perpetuities clause in wills and trusts provides that the trusts contained in them terminate automatically at the required time. This protects the legality of the trust.

**PERSONAL PROPERTY.** Movable property as contrast with real property, which is fixed in place. Personal property includes money, furniture, automobiles, and equipment.

**POWER OF APPOINTMENT.** The actual power or legal authority given by the deed or will of one person, the donor of the power, to a second person, the donee of the power, which enables the second person to sell, transfer, contribute, mortgage, or dispose of property owned by the first person. A power of appointment may be general or special, as defined below.

**GENERAL POWER.** Enables the second person to do all those acts for himself, his creditors, his estate, the creditors of his estate, or any other person.

**SPECIAL POWER.** Limits the second person concerning the persons to whom he can transfer the property over which he has a power of appointment. The limitation of appointment can be very specific, e.g., to a group consisting only of the children of the first person, or the children of the second person. But never can the second person appoint, i.e., “give,” the property to himself, his estate, his creditors, or the creditors of his estate, because this would defeat the purpose of the special power, namely, to keep the appointive property from being taxed in the estate of the second person on his death.

**POUR-OVER WILL.** A will that provides for the transfer, after or during the probate court proceeding, of the net assets of the deceased person from the executor’s control to the control of a trustee who is in charge of a trust that was in existence immediately before the death of the deceased person. The executor pours over the assets into the open vessel of the existing trust.

**PRESENT INTEREST.** See Gift tax annual exclusion.

**PROBATE.** The court proceedings in which the probate court has jurisdiction over the executor and the assets of the deceased person. The purposes of probate include protection of:

- (1) The heirs from fraud and embezzlement;
- (2) The federal, state, and local governments so that all taxes are paid by the estate; and
- (3) The creditors of the deceased person so that they are paid.

Probate starts with the will being admitted to probate and the executor being granted “letters testamentary.” Probate ends after all taxes are paid, creditors are paid, and assets are counted for and distributed as provided in the will. Probate lasts approximate nine months to two years or more, depending on the complications in the estate.

**QUASI-COMMUNITY PROPERTY.** In California only, property that, had the couple been living in California while married, would be considered community property. For example, husband and wife are married and living in a non-community property state for 3 years, later they move to California, a community property state. The property acquired during the couple's marriage in the non-community property state, other than by gift or inheritance, is considered quasi-community property, and therefore considered community property for all intents and purposes.

**REAL PROPERTY.** An interest in land, or property permanently affixed to land such as a building.

**REMAINDER INTEREST.** The residual ownership of property left in trust after a previous owner or after the life tenant received all the property benefits to which they were entitled.

**REVERSIONARY INTEREST.** The future return to ownership of property by a person who for a period of time surrenders his ownership in trust or outright to another person. After that period, the property "reverts" or comes back to the original owner.

**REVOCABLE TRUST.** A trust whose terms and provisions can be changed, modified, altered, amended, or revoked. The power to do all this is usually reserved by the person who created the trust, but sometimes the power may be given by the creator to a second person. The revocable trust is becoming popular as a means of avoiding probate and as a substitute for a will. The revocable trust is often used for aged people to protect themselves and their assets from the expense and delays of conservatorship. Before using a revocable trust, a person should consult with an attorney who is experienced with revocable trusts.

**RIGHT OF REPRESENTATION OR PER STIRPES.** Refers to a method for dividing property on the death of a beneficiary. The descendants of that beneficiary take the same share or right that the beneficiary would have received had the beneficiary lived. Contrast this with per capita division in which each beneficiary (e.g., grandchild) receives the same amount as the other beneficiaries of the same relationship (i.e., the other grandchildren).

**SEPARATE PROPERTY.** In California, a category of property held by husband and wife that is not community property, but that is owned separately by the husband or wife. The problems of separate property arise generally in marital dissolution and in the determination of death taxes. Gifts, inheritances, and property owned before marriage are usually considered separate property.

**SPENDTHRIFT TRUST.** A trust that provides a fund for the maintenance of a beneficiary, which by its terms insulates the beneficiary's interest from the beneficiary's improvidence, incapacity, and the claims of creditors.

**TENANCY IN COMMON.** A form of holding title to real or personal property by two or more persons. Because there is no right of survivorship, the legal relationships and results are very different from joint tenancy. Title to property should be taken by a person only after consulting with his attorney because the effect on income tax, estate tax, death rights, etc., varies depending on how title is held.

**TESTAMENTARY TRUST.** The trust that comes into being only as a result of the death of a person whose will provides for the creation of the trust after his death; hence, the term "testamentary."

**TESTATOR.** The person who makes a will. Testatrix is the female equivalent, but it is common as a convenience to use the term testator for either man or a woman.

**TRUST.** A legal entity established either by a trust agreement signed by a person during his life or arising after death from a will or testamentary trust. The trust is governed by the terms in the documents. They can last as long as 50 years, if not longer, so it must be written with great care.

**TRUSTEE.** The individual or corporation who in a trust has legal title to the assets and has the power given in the trust to carry out the wishes of the persons or persons (trustor) who created the trust. The trustee has a fiduciary obligation to the trust's beneficiaries. The trustee is subject to strict regulation. Although he has legal title for convenience, the beneficial or equitable title is in fact owned by the beneficiaries. When there is more than one trustee, the trustees are called co-trustees.

**TRUSTOR.** The person who establishes the trust (sometimes referred to as "settlor"). There can be more than one trustor.

**UNIFIED ESTATE AND GIFT TAX.** A federal tax imposed upon the net value of an estate and on gifts of certain amounts. The transferor is liable for the gift taxes but if the transferor fails to pay the gift tax, the transferee may be held liable for its payment. I.R.C. §§§§2001 et seq. And 2501 et seq.

**UNIFIED TAX CREDIT.** A federal tax credit that may be applied against the gift tax, the estate tax, and sometimes the Generation-Skipping Transfer tax. For Gift Tax Purposes in years 2006, 2007 and 2008 the Unified Credit is \$345,800, the Applicable Exclusion Amount is \$1,000,000. For Estate Tax Purposes in years 2006, 2007 and 2008 the Unified Credit is \$780,800 and the Applicable Exclusion Amount is \$2,000,000.

**WILL.** The document a person signs to provide for the orderly disposition of his other assets after his death, in accord with his wishes to provide for family security and protection and to minimize death taxes.



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