# October 2015 Seminar: Trust Planning

## Important Factors to Consider When Creating Your Revocable Living Trust

**DETERMINE YOUR OBJECTIVES:**

A. Provide For Your Loved Ones
B. Avoid Probate
C. Choose Your Trustee Wisely
D. Prevent Family Drama
E. Tax Planning: Prevent/Reduce Taxes at your death

**A. PROVIDE FOR YOUR LOVED ONES:**

a. **Outright Gifts**: Outright gifts are made to your beneficiaries after your death by your trustee:

   i. **Advantages:** They get the gift right away upon distribution after trust administration is completed.
   ii. **Disadvantages**: No creditor protection in case of divorce, creditors' claims against the beneficiary. There is no asset protection, they can lose the gift once it is in their possession.

b. **Staggered Gifts**: Gift/devise is distributed in stated increments of years: 5, 10, 15, etc.
   i. Age of beneficiary
   ii. Discretion of Settlor
   iii. Incentives on beneficiaries

c. **Lifetime Subtrust for Beneficiary**: Devise stays in trust for beneficiary's lifetime. He/She never has the opportunity to hold title to the assets. But he/she is a beneficiary of the trust and can receive income/principal based on trust's provisions.

   i. **Advantages**: Lifetime asset protection for the beneficiary. He/she cannot lose what he/she does not own.
   ii. **Disadvantages**: He/she would never own/control the asset. He/she cannot devise it to their successor according to their own wishes because the trust already does so. *Generational Dynasty Trust anyone?*

d. **Equal Division:** Is division ever equal if your children are of different ages?

i. **The Family Pot Trust for Children**: Distribution is to a Pot Trust for ALL the children until the youngest reaches a designated age (likely post college age). Trustee is usually given discretion to "SPRINKLE" the funds in the trust based on each child's needs: HEMS

ii. **Discretion of Trustee**: If trustee has "sole", "absolute", or" uncontrolled" discretion to distribute trust assets, he/she SHALL still act according to Fiduciary Principles, not bad faith or disregard purposes of the trust – P.C. 16081.

***Planning Tips:***

*a. What you decide to do should be based on your family's circumstances which you know best because you know your children/loved ones. Avoid the one size fits all approach.*

*b. Be sure to have detailed conversations with your drafting attorney to guide you.*

*c. It is a Revocable Trust, which means it can be changed/modified as your family circumstances change.*

**B. AVOID PROBATE:**

a. **What is the Value of Your Assets**: P.C. Section 13100 – Gross value of estate exceeds $150,000.00. All assets properly FUNDED (transferred) into your trust avoid probate.

b. **Funding (Transferring) Assets in to Your Trust**: Failure to properly fund your trust can have dire consequences for both the trust and the attorney. Some factors to consider before funding your trust are:

i. Will it be held outside of the trust?

ii. Is there an agreement (Pre-marital, post-marital, marital dissolution agreements, or other property agreement such as Joint Tenancy) that prevents the assets from being transferred into the trust?

iii. Is there a tax disadvantage to transferring it into the trust, e.g. spousal retirement plan roll over that continues its tax deferral in contrast with Life Insurance Policy?

iv. Family circumstances: minor beneficiaries of normal "Payable on Death" (POD) beneficiary accounts.

c. **What Assets Can you Fund into Your Trust**:

   i. **Residential real property in California or outside California**: Use a grant deed and PCOR for CA; and Warranty Deed for other states where applicable.

   ii. **Time shares in or outside California**: Send Trust Certificate to Timeshare managers in or outside California.

   iii. **Stocks**: Meet with or contact stockbroker to set up new trust account; find original stock certificate for re-registration of stock in trust name.

   iv. **Closely held business interest such as S-Corp or LLC**: Review Bylaws to see if any restrictions. Transfer interest and not the property.

   v. **Professional practice**: See regulatory rules for practice and transfer of interest in practice at death of practitioner.

   vi. **Municipal Bonds/Treasury Bonds**: Bond certificate required. Mail Certificate of trust to Bond agency. List account numbers on Schedule of Trust: Schedule A, or W or H, or C.

   vii. **Life Insurance Policy, IRA, 401k, Annuity**: Obtain beneficiary designation forms from the insurance company, or plan provider, and re-designate the trust as the beneficiary of the policy, IRA, 401K, or annuity.

   viii. **Promissory Note & Deed of Trust**: Identify the note by date of execution and recording if it was recorded.

   ix. **Anticipated Inheritance**: Identify the anticipated inheritance very specifically.

   x. **Liquid Assets (Bank/CD/MM A/Cs)**: Request that your bank changes title to your account from your name to your trust.

   xi. **Automobiles and Boats**: Register with DMV or US Coast Guard if required.

***Planning Tips:***

*a.* *Always ensure that the asset you are funding into your trust is specifically identified in the schedule of your trust so that even if the formal funding is not completed before you pass away, your trustee can use a Heggstad Petition to fund the asset into your trust even after your death.*

*b.* *Always amend your trust when you acquire a new asset, or you no longer have an asset that you had when you created the trust.*

## C. CHOOSE YOUR TRUSTEE WISELY:

a. **What to Consider in Choosing Your Trustee**:

i. Who can implement your wishes when you are not here?
ii. It is a business, so choose the person who has the most business aptitude and can cope with the intricate details that are required.
iii. Age: Chose a trustee who is close in age to your beneficiary/ies;

**b. Family Member or Professional Fiduciary:**

i. **Family Member**: Knowledge of family circumstances can be an advantage and/or a disadvantage.
ii. **Professional Fiduciary**: May not have knowledge of family circumstances, but is effective and efficient in carrying out your trust wishes. May negotiate with Settlor and earn the same amount in fees that a family member trustee earns.

c. **Choosing a Co-Trustee: Is it Necessary? Beware the DANGERS**

i. **Advantages**: Advisable only when **<u>ABSOLUTELY</u>** necessary, example when surviving spouse trustee is unable to carry out trustee duties due to age, etc.
ii. **Disadvantages**:
a. Constant Disagreement between two or more people with their ideas on how the trust should be run.
b. Almost always leads to litigation in the trust.

***Planning Tips:***

*a. It is advisable to avoid having Co-Trustees in your trust. Instead use a Trust Protector (**Guardian Angel who is not involved in the day to day administration of trust duties**) with power to remove a non-cooperating Co-trustee so as to avoid unnecessary and expensive litigation.*

*b. Add an incentive for reasonable compensation for Co-Trustees, example that they complete administration within a designated time period from date of death in order to be compensated as trustee.*

c. *Probate Code Section 16013: Requires co-trustee to participate in the administration of the trust; and requires a co-trustee to prevent another co-trustee from committing a breach of trust duties.*

d. Trustee's Power of Distribution: Exercising Trustee's Discretion:

i. Trustee's discretionary power to distribute income or principal may be "sole", "absolute" or "uncontrolled". He must act in accordance with **Fiduciary Principles** and not in bad faith. P.C. 16081.

ii. If he is a beneficiary and also trustee/co-trustee with discretionary powers to distribute to him/herself as a beneficiary, he must distribute according to the standard set for such discretionary distributions which are usually his HEMS (health, education, maintenance and support) needs only. P.C. 16081.

## D. PREVENT FAMILY DRAMA:

See/Read my article: Prevent Family Drama, Plan for the Inevitable
www.ukohalaw.com/resources/articles

## E. TAX PLANNING: PREVENT/REDUCE TAXES AT YOUR DEATH

### Taxes that Arise Upon Death

a. **Estate Taxes**: Also known as the "Death Tax". It is levied on the assets of a deceased person if the **net value** of those assets is $5.43M (2015 amount) which increases yearly. Those assets include life insurance policies (unless it is in an ILIT – Irrevocable Life Insurance Policy), Retirement Plans, Investment Assets, Cash, Property, etc. Must be paid within 9 months from date of death unless an extension is obtained. Tax is 40% if assets are over the threshold amount of $5.43M at death.

   i. $5.43M is exempt from taxation for each person. So for a couple it is $10.86M that is exempt.
   ii. It is portable: A surviving spouse can use the remainder of what his/her decease spouse did not utilize of his/her $5.43M amount at death to protect the surviving spouse's estate from being taxed in addition to the surviving spouse's exemption amount.

b. **Capital Gains Tax on Jointly Held Property**: Taxes on the gain on one half of property that has appreciated in value when sold.

   i. "Basis": This is the amount for which you purchased the property
   ii. "Stepped Up Basis": The amount for which you "got" the property when you received it.

**Contrast these Examples**:

1. If mom adds her child's name on title as a joint tenant to her property that she purchased for $100,000 in 1980. At her death in 2015, the property is valued at $500,000. If daughter sells the property at that amount, there is a gain of $400,000. She will pay capital gains taxes of 20% on one half of the gain of $200,000.00 because she only receives a stepped up basis on one half of the property, her mom's share of the joint ownership.

2. If mom creates a Revocable Living Trust and devises the same property that she purchased in 1980 to her daughter who receives it at her death in 2015. If she sells it for $500,000.00, she will pay $0 Dollars in capital gains on the property because she gets a full stepped up basis on the property. That means her new basis (the amount for which she "got" the property), is the value on the date of mom's death: $500,000.00. Because she sold it for that amount, there is no gain and therefore no tax on the sale. She would only pay taxes if she sells it for more than the value on the date of mom's death.

**70 WASHINGTON ST, STE 303 @ JACK LONDON SQUARE**
**OAKLAND, CA 94607**

**510.834.9944**
**endy@ukohalaw.com**

**www.ukohalaw.com**