<u>ESTATE PLANNING FUNDAMENTALS</u>

Yes, the old saying is true... there are two things that no one can avoid: death and taxes. The ultimate irony is that one of these events (death) is sometimes a leading cause of the other (taxes).

Like me, I'm sure you want your spouse and children to receive the full benefit of the nest egg that you've spent so many years trying to build. You'd like to make sure that your estate goes to the people you specify, at the time you specify and in the manner you specify. You want the least possible cost in taxes and probate expenses, and the least possible delay in distribution to your heirs.

These goals can be obtained through proper estate planning. I know that it's not fun to focus on death, but your willingness to plan ahead for the inevitable day that you are no longer there could make a crucial difference in the quality of life for your family after you're gone.

This report will summarize what I consider the five most important facts that everyone must consider when they plan their estate. Whether you are young or old, or have a large estate or a small one, you should consider the following facts when you are deciding what will happen to your estate and to your family after you are gone.

1. <u>A will or trust lets YOU pick your beneficiaries, and not leave it up to the legal system.</u>

Do you know what happens when you die without a will or trust? This is called dying "intestate." Your estate will pass to your heirs according to complex rules set by law. Sometimes this may be what you would want, but sometimes not.

Let me give you an example. If you are married without children, and die without a will, your community property will be left to your spouse, but any separate property will be divided between your spouse and parents. What if you have a spouse and three children? Your spouse is entitled to all of the community property of the marriage, but will get only 1/3 of your separate property, and your children will equally divide the other 2/3 of your separate property. Is this what you wanted? Your children will receive their shares when they reach legal age—18 years old. Will your children be able to manage their inheritance at that age?

If you have a will or a living trust, <u>you</u> specify who gets your estate and when, not the court system. You can make sure your spouse is adequately protected. You can appoint someone to administer any assets you leave to your children until they are old enough to handle this money on their own.

2. <u>A will or trust lets YOU pick guardians for your children.</u>

A will or trust can also be used to specify your preferences for a legal guardian for your children if both parents have passed away. If you'd like, you can specify someone to handle the day-to-day upbringing of your children, and someone else to handle the money. The preferences of the parents specified in their wills are ordinarily respected by the courts.

What would happen if you died without picking a legal guardian for your children? Is this something you want to leave to the court system to decide for you?

3. A well drafted estate plan can help you avoid (or minimize) inheritance taxes.

Throughout your working years, the government has been taking a share of your earnings in the form of income taxes. Many of you might assume that, by the time you pass away, you've already paid your fair share, and that the IRS will let you "rest in peace" (pun intended). Not necessarily so. For some people, their assets will be taxed again on death.

Luckily, Congress has protected many estates from this second tax. Under recent legislation, if you die in 2011 or 2012 and your estate is worth less than $5,000,000, your estate will not owe inheritance taxes.

In addition to this "exemption" amount, there is no inheritance tax for any property (regardless of amount) you properly leave to your spouse (assuming he or she is a U.S. citizen). This is called the "marital deduction." If you leave all your property to your spouse, there will be no inheritance tax when you die.

As a result of these two rules, many of you will not have to pay inheritance taxes. However, I should warn you that there are several additional factors you need to consider. Did you realize that your life insurance polices are considered in determining the size of your estate for inheritance tax purposes? Did you consider what happens when the second spouse dies? Or if the second spouse remarries?

If your estate is of sufficient size that estate taxes are a concern, we should discuss whether additional estate planning options are available to avoid or minimize inheritance taxes.

4. A Living Trust can minimize the expense and delay of settling your estate.

Inheritance taxes are not the only cost associated with most estates. Another key factor to consider is the expense of "probate" of your estate. "Probate" is a court process. An executor of your estate is appointed, an inventory of your assets is prepared and appraised, notices of death are published, creditor claims are received and adjudicated, estate tax returns, if necessary, are filed, accountings are prepared and approved by the court, and finally the estate is "closed." This process can often be very time-consuming.

More importantly, the probate process can be expensive. Both the executor and the probate attorney are entitled to a fee. The standard fee is set by law, and is a sliding scale based on the size of the gross estate. For an estate of $500,000, the executor would be entitled to $13,000 and the attorney would be entitled to $13,000, or possibly more, if the attorney has provided "extraordinary" services. There are also court filing fees and other costs to consider. As the estate (as measure by gross value- not net equity) increases, so do the fees. If the estate is worth one million dollars, the combined fees of the executor and attorney will total $46,000.

Is probate always required? No. Generally, if the gross value of your estate is less than $100,000, you are a "small estate" and do not need to go through full probate. If you leave all your assets outright to your spouse, then a streamlined court procedure is available, instead of a full probate.

You can also avoid the costs and delays of probate for certain types of property. For example, life insurance proceeds payable on your death do not necessarily go through probate. The same is true with IRA's or other retirement accounts. These items pass directly to the persons specified by you as the beneficiary.

Another common technique is to put your property (such a bank accounts, cars or real property) into joint tenancy. Joint tenancy is a specific way of holding title to property. On the death of one joint tenant, the entire property passes directly to the other joint tenant. Probate is not necessary—all that is required is a certified copy of a death certificate and a signed affidavit by the surviving joint tenant showing that the other joint tenant has died.

Listing your children or other beneficiaries as joint tenants might make sense in some circumstances, but not all. The key to remember about joint tenancy is that you are giving the other joint tenant a current interest in the property. Any judgment against the other joint tenant now becomes a lien against the property. The other joint tenant may want to sell the property. If you don't agree, the joint tenant can take you to court to have the property sold. The other joint tenant does not have to wait until you die. And you cannot change your mind and get your property back unless the other joint tenant agrees.

A better probate avoidance technique is one you have probably heard about -- a Living Trust. The technical term for this type of instrument is a "revocable intervivos trust." This might sound complicated, but it really isn't.

With a living trust, the grantors of the trust (typically the husband and wife) put their assets into a trust. They can be the trustees of that trust. During their lives, they can have broad control over the trust assets, and can even revoke the trust if they so choose. The grantors pay income taxes on the trust assets as though they still owned them. On the death of the grantors, the trust assets are distributed as they specify. For purposes of inheritance taxes, the government treats the property as though it was still owned by the grantors at the time of death, and therefore the rules I mentioned above about the exemption amount and marital deduction come into play. However, (and this is the key to the entire living trust concept), the law does NOT consider the assets in the trust to be part of the grantor's estate for purposes of PROBATE.

As you can imagine, living trusts can save many thousands of dollars in probate expenses, which is the main reason they have become so popular. Although a living trust costs a bit more to establish in the beginning than a standard will, that extra cost is usually outweighed by the enormous savings in probate costs on death.

Two of the other principal benefits of living trusts are (1) it is usually much quicker to administer the trust after death than probate a will, and (2) court proceedings and public filings are usually not required, which provides for a greater level of confidentiality and privacy for the deceased and his/her family.

The most overlooked aspect of a living trust is that you have to make sure that you actually transfer your assets into the trust to get them out of your estate for probate purposes. This is called "funding" the trust. You will have to sign a deed to your property to put it into the trust. (Don't worry—you can still claim your homeowner's exemption for tax purposes even if the trust owns the property and your property taxes will not be reassessed.) You will have to change the name on your bank accounts and the other assets you want to put into the trust.

What if you forget to put some of your assets into the trust? Whenever you have a living trust, you should also have a will to specify what happens to the assets that were not in the trust. The typical will in this situation is called a "pour over" will because it states that any assets that were not in the trust at the time of your death get "poured over" into the trust when you die. Of course that pour over will must now go through probate, (unless your non-trust estate has a gross value of less than $100,000), so it is smart to make sure most of your assets are in the living trust.

5. The best time to develop an estate plan is . . .

You probably already know the answer to this one, but it is so important that I have to put it on my list. The best time to develop an estate plan is ... RIGHT NOW.

I don't mean to scare you, but can you really predict what will happen to you tomorrow? Is your current estate plan, if you have one, up to date? If you were to pass away in the near future, would your assets go to whom you want, when you want, and with a minimum of cost and taxes? Have there been any changes in your life (divorce, remarriage, change in finances) that affect your estate plan?

Don't feel bad if you haven't done an estate plan or if it's not up to date. You are not alone. No one wants to focus on death. Many people dislike lawyers and are confused by words like "intestate," "intervivos trust" and "probate." You may not know the best way to proceed. Should you have a will or a living trust? The choices are not always easy and it is often tempting to put off the tough decisions until later.

My final tip is that most estate plans--such as wills and living trusts--are completely revocable. In other words, you can change your mind later. My recommendation is to get the best estate planning advice and make the best decisions you can (considering both financial and non-financial factors) based on what you know today, and then be prepared to change your estate plan in the future if your circumstances change. I have found that this approach takes much of the stress out of estate planning, and helps relieve many clients from the nagging guilt, worry and/or anxiety they feel about the possibility of passing away without any estate plan at all.

Prepared by ROGER J. ILLSLEY. Since 1980, Mr. Illsley has been serving clients in Sonoma County, with special emphasis in the areas of business and real estate law. He has been a Professor of Law at Empire College, School of Law since 1985, teaching classes in Commercial Law and Contracts. He can be reached at the lawfirm of Perry, Johnson, Anderson, Miller & Moskowitz, LLP. 438 First St. 4th Floor, Santa Rosa, CA 95404 (707) 525-8800. His email is illsley@perrylaw.net.