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NEWSLETTER JANUARY 2016

To Our Clients and Friends:

In this Newsletter, we will continue to update you by briefly covering topics that we've found to be of the most current interest to our clients.

USING WILLS & TRUSTS TO PROTECT INHERITANCES FOR CHILDREN.

Without parents or grandparents having a Will or Trust to direct an inheritance, children would have a right to receive all funds at age 18. While a child is younger than age 18, the Court is involved bi-annually to review, supervise, and approve investments and expenditures of funds for the child. As one might imagine, a child's guardian needing to frequently hire an attorney to prepare reports for the court results in many hours of expensive legal work. Thus, we strongly recommend that our clients avoid this Court supervision by having a Living Trust or at least a Testamentary Trust (which is a Trust established through Probate under the terms of a Will). A Trust can allow the designated Trustee to independently manage and invest the child's inherited funds without costly supervision by the Court. Just as important to many families is to protect the child by arranging in the parent's Trust for the designated Trustee to retain control over the funds until the child reaches a more "mature" age. Many parents want funds protected in trust until age 35, after college has been completed, and after the child has begun a job and learned to manage a budget; at age 35 the child is expected to be more mature in selecting investments and will have had the funds protected as separate property from a possible early divorce.

THE TRUSTEE'S DUTY TO ACCOUNT TO BENEFICIARIES (AND AVOID LATER LAWSUITS).

In a prior newsletter, we discussed how to select a Trustee who would administer funds for the beneficiaries; many times, a family member or close friend is selected. In this article, we discuss how to protect the unwitting wanting-to-do-good person who takes on the job of Trustee, only to be later sued by the beneficiary.

Most or all Trust documents, and the California Probate Code, direct that the Trustee account to all beneficiaries annually, detailing assets at the beginning and ending of the year, all income items, and all disbursements. The Probate Code generally gives a beneficiary three years to sue and to oppose the Trustee's actions as disclosed in the Accounting. It is possible in the Trust document to limit the time (the statute of limitations) to six months rather than the three years. Most of our Trusts have a limiting provision so that the Trustee can have some comfort in avoiding an attack years after events have taken place.

Since preparing an Accounting can take considerable attorney and/or accountant time, adult beneficiaries, in situations where they trust the Trustee or where they already have been receiving copies of bank or broker statements and are informally aware of the financial transactions, may choose to "waive" an Accounting. This means that the beneficiary is satisfied with the financial information that has been informally shared, signs a Waiver indicating that there are no questions or challenges, and that the financial information is accepted and the Trustee's legal duty to account has been "waived".

With any Irrevocable Trust, the Trustee has a duty to account to beneficiaries. If an Accounting is never given, or never waived by the beneficiary, then the beneficiary's statute of limitations to question the financial decisions of the Trustee never starts to run. This may include a "Decedent's Trust" that the surviving spouse is managing after the death of the first spouse, where the ultimate beneficiaries after both deaths are the children–the surviving spouse should account to the children or obtain a Waiver of Accounting each year. This may also include an Irrevocable Life Insurance Trust, or other type of Irrevocable Trust, where a family member, friend, or professional is the Trustee.

In our litigious society, most Trustees now have their lawyers or accountants prepare and deliver formal Accountings to beneficiaries, or at least obtain written Waivers from the beneficiaries. Alternatively, the Trustee may decide to protectively file a formal Accounting with the Court, mailing written notice to the beneficiaries, and asking the Judge to review and approve all financial transactions so that the Trustee can never be questioned in the future about those disclosed actions.

We counsel our clients to name only trusted family members or friends as Trustees, or to use an institutional Trustee, such as a bank that specializes in the Trust business. Then, we later counsel those trusted family members or friends who actually take on the job of Trustee to be careful in their actions, so that the Trust beneficiary will receive proper notices and financial information, and many times will then choose to waive a formal Accounting to avoid further professional fees from depleting the Trust funds.

THE (AVOIDABLE) PROBATE COURT PROBLEM WITH MAINTAINING SEPARATE PROPERTY

Our Court system does an excellent job at protecting the assets of an incompetent or deceased person. In many instances, however, it is expensive overkill, and clients can plan in advance how to achieve personal objectives and also protect the family resources.

We recently had a situation where Wife was incompetent, as attested to by her physicians. Most assets were in the Family Living Trust of Husband and Wife, but Wife's IRA and inherited savings account were in her own name. Wife and Husband had been married for decades, but she still apparently wanted some assets to be in her name alone.

Without a Power of Attorney or Living Trust in place, Husband needed to petition the Court to appoint him as her Conservator in order to sign her name to the accounts while she was incompetent. To achieve a complex appointment as a Conservator, Husband needed to pay substantial legal and Court fees, including for a Court appointed investigator and a Court appointed attorney to report on whether his Wife really needed a Conservator, and then to give continuing reports to the Court over how each penny was spent. When Wife passes away, Husband then would need to petition the Court to close the Conservatorship, and if Wife's separate assets are more than $150,000, a Court Probate would be needed.

Wife could have easily kept assets separate and also helped her Husband to protect her and the family in case of her incompetency or death. She could have signed a Power of Attorney to "spring" to effectiveness only in the event of her incompetency, so that Husband (or adult child) could then sign on these accounts if necessary to pay for her medical or care giver expenses. She could have directed us to create a Separate Property Living Trust that would hold only Wife's accounts and which would name a successor Trustee to manage the assets for her or the children in the event of her incompetency or death. Alternatively, she could have added the inherited savings account to the title of the existing Family Trust, amending the Trust to specify that it belonged to her alone, and that she alone as Trustee could sign on the account so long as she was competent.

NEW REVOCABLE TRANSFER ON DEATH DEEDS ("RTOD" DEEDS)

Effective after January 1, 2016, new California Probate Code Sections 5600-5696 allow owners of a residence to pass the real property to one or more beneficiaries on the owner's death, thereby avoiding probate and the need of a Living Trust for VERY simple situations.

This opportunity may best be used for a person who owns only a residence and bank or investment accounts, and has a very close and trusting relationship with one's children. The RTOD Deed, in a form mandated by statute, can be signed by the owner to designate one or more beneficiaries to inherit the property on death. Such a Deed cannot include any protective Trust terms or back-up beneficiaries, such as, "I designate my son, and if he is not living at my death, then to my granddaughter." In this example, if the son weren't living, then the Deed would fail, as if it had never existed, and the residence would go through probate to be distributed as directed in the Will, if any, or by intestacy. If three beneficiaries are named and one is not living, then the other two would take equally. The beneficiary named in such a Deed need not be told about it (although it is public record), and the person signing the RTOD Deed can revoke the Deed at any time. Such a Deed must be recorded in the County's public records within sixty days of its execution.

During the owner's lifetime, the RTOD Deed does not affect, pro or con, the impact of Proposition 13 on property taxes, existing mortgages, creditor protection, or Medi-Cal resource protection.

For more complex estates, a Living Trust and Power of Attorney will still be preferable to allow easy management of a residence before death to protect against incompetency, and after death if beneficiary designations are to be retained or protected in trust.

USING THE BENEFITS OF PORTABILITY OF THE ESTATE TAX EXEMPTION

The use of "Portability" by the surviving spouse, elected on an Estate Tax Return filed nine months after the death of the first spouse, is becoming common. The Portability Election allows the surviving spouse to use up to double the estate tax credit (e.g. $5,450,000 times 2 as of 2016), while only needing a very simple Trust or even by inheriting outright ownership by the surviving spouse. (See our earlier discussion of Portability in the 2014 Newsletter on our Firm's website for more details.)

Married couples who haven't reviewed their Trusts since the end of 2012 when Portability became so useful, will want to consider the pros and cons of planning for it. We should continue to remember a downside, however, in that avoiding the use of a Bypass or Decedent's Trust by leaving property outright to the surviving spouse means that the surviving spouse has the right to remarry and then bequeath everything to a new spouse, with nothing to the children.

IRS REGULATIONS EXPECTED TO IMPACT FAMILY DISCOUNTS

Rumors during 2015 were that the IRS would soon (for issuance early in 2016) issue Proposed Estate and Gift Tax Regulations ("Regs") to end the taxpayer's ability to claim marketability discounts for gifts and bequests to family members. There are experts who opine that the IRS has no authority to define what "fair market value" is between family members - only Congress can define how to interpret the meaning of fair market value. Many times we claim a marketability discount on a gift or estate return for a jointly owned asset because appraisers believe that it is less marketable and that it is more difficult to take certain actions such as sales and refinancing since consents of others would be required. The IRS wants to plug what it believes is an abuse when the lifetime or death transfers of partial interests are between family members, rather than arms-length transactions with strangers.

In the meantime, clients who want to gift to children interests in LLC's, partnerships, real

property, etc., may want to complete the gifts before any IRS Regs are issued, to be safe. Remember that with the estate tax credit raised to $5,450,000 in 2016, those clients with lower estates wouldn't normally be advised to make any gifts of appreciated property, as it is better to die with the assets and for the children to receive an income tax basis step-up.

RETIREMENT PLAN BENEFICIARIES

Should continue to check their IRA, 401K, 529 Plan and other beneficiary designations. As banks and financial vendors continue to merge and change names, we've experienced that the Beneficiary Designation Form that clients filled out a few years ago may be "lost" among their records. So, we suggest that you contact your IRA custodian or pension administrator and confirm who your beneficiaries are. It would be wise to also request a conformed copy of the Beneficiary Designation for your records (in case records are later misplaced by the custodian).

If there is no beneficiary properly designated on death, your retirement funds could be forced to go through Probate (or could end up in a Court guardianship for young children). Normally, one designates their spouse as primary beneficiary, and responsible, mature children as secondary beneficiaries, or alternatively designates a Living Trust for the children, which Trust would include special "flow through" provisions to allow optimal income tax treatment of retirement funds.

One should be careful soon after a spouse dies to roll all inherited plan benefits to their own IRA, and sign an updated beneficiary designation, as the deceased spouse's initial designation is usually void.

CHANGES IN LLC LAW

California has recently revised its LLC law. The new law, called the California Revised Uniform Limited Liability Act, contains many default provisions. If an LLC Operating Agreement does not adequately address certain provisions, the new law will impose the terms which may or may not reflect what the owners intend. This could include the consent necessary for the LLC to take certain actions. If your Operating Agreement has not be reviewed since 2014, you may want to do so to make sure that the members' intent is still reflected in the Operating Agreement.

NEW IRS TAX BASIS REPORTING REQUIREMENTS FOR PROPERTY ACQUIRED FROM A DECEDENT

New income tax basis rules (IRC Sections 1014(f) and 6035) were enacted in 2015, to cover beneficiaries who inherit property from a Decedent if the Decedent's estate was required to file an Estate Tax Return, Form 706 (i.e. for estates larger than $5,450,000), which is filed on or after July 31, 2015. The Executor/Trustee must notify each beneficiary and the IRS as to the Form 706 value of the assets, no later than 30 days after the 706 is filed (or is required to be filed, including extensions). As of early 2016, the IRS has not issued the form required to be used, and the deadline for filing the form has been extended to February 29, 2016.

Copies of this Newsletter and those of prior years can be found on our Firm's website, www.magasinn.com.

We send all of you our best wishes.

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