

ESTATE PLANNING 101

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Why do Estate Planning?

Determine what you want to do with your assets during life and after death

- Provide for self, spouse, children
- Provide for family members with special needs
- Benefit charities

Minimize taxes so you can control more of your assets

Avoid family disputes

What Happens If You Don't Do Estate Planning?

Possible chaos during period of incapacity.

- Spouse and children fighting or trying to figure out what you want.
- Who will be guardian in event of both parents' disability or death?

After death, assets are distributed based on:

Beneficiary designations

Intestate succession (default state law): CA law

Community property to spouse

Separate Property: If the deceased had only one child, the surviving spouse will receive one-half and the child will receive one-half. If there is **more than one** child, the surviving spouse will receive one-third of the *separate* property, and the children will receive equal shares of the remaining two-thirds.

What is a Basic Estate Plan?

1. Will

- Basic document to name beneficiaries to whom you wish to leave assets
- Name guardians for children
- May Include a testamentary trust for children

2. Durable Power of Attorney

Effective when you are unable to make your own decisions.

- Designate agent to carry out financial affairs (i.e. pay bills, sell or buy assets)

3. Directive to Physicians

- Lets you express your wishes regarding life support and certain personal restrictions regarding medical care/needs

Revocable Living Trust

- ◆ Living Trusts may be useful in avoiding the Probate process (i.e., a court procedure to distribute your assets)
- ◆ No tax benefits unless other tax saving devices are specifically included (the same tax saving devices may be in a Will)
- ◆ If there is Real Property in another state, it may be best to place the property in a Living Trust to avoid Probate in more than one state

How Does a Living Trust Work?

- ◆ Assets (i.e. house, stock accounts, bank accounts, etc.) must be in Trust;
- ◆ Assets left outside the Trust subject to Probate
 - unless the value of non-trust assets is below the State's applicable minimum
 - ◆ **(CA: \$100K)**
- ◆ In most cases, Trustors continue to manage assets as Trustees (the managers of the Trust) until successor trustees (for example, adult children) step in as Trustees upon incompetence or death of Trustors
- ◆ All taxes due reported on the Trustors' tax returns
- ◆ The Trustors may claim the same deductions and personal residence sale exemptions

Special Issues to Consider for Your Estate Plan

- Special Needs Trust for children or elderly
- Trust to support spouse while benefiting children of prior marriage
- Succession planning for closely held business
- Trust as prenuptial planning
- Charitable gifts
- Life Insurance Trusts

Estate Taxes

Estate and Gift Tax are transfer taxes. The IRS imposes a tax on the transfers of your assets to someone else either during life or at death.

Exceptions:

- Gifts to US citizen spouses (or QDOT) under the Marital Deduction
- Gifts of \$11,000 per year to anyone
- Gifts by non-citizens of intangible assets in U.S. or property outside U.S.

Transfers to anyone else are taxed unless Lifetime exemption amount is used.May also require reporting to the IRS.**

Estate Taxes

 **Estate taxes and IRS Form 706 are due 9 months after date of death**

- Need for liquid assets to pay the tax

The audit rate for estate taxes is much higher than for income taxes

- 18.88% for estates between \$1 million - \$5 million*
- 47.43% for estates over \$5,000,000*

*1997 audit rates

Estate and Gift Taxes

- Everyone is allowed to give \$2,000,000 (2006) at death without tax.
- During life, \$1,000,000; May require filing 709 with IRS.
- Beyond \$2,000,000 (2006) all money which is left to others is taxed at rates up to 47%.

Estate Taxes – A Basic Illustration

Usual pattern of leaving assets to surviving spouse and then to children is costly.

Husband & Wife Total Assets	\$3,000,000
Husband → Wife → Kids	\$3,000,000
	\$ 1,500,000 Exempt
	\$ 1,500,000 Taxable

Estate Planning Reduces Taxes

Husband → Trust

\$1,500,000 to Bypass Trust
Tax Free (Using Exemption Amount)

Wife → Kids

\$1,500,000 Kids Tax Free
(Sheltered by Exemption Amount)

Trust Corpus → Kids

\$1,500,000 Tax Free

NEW TAX LAW

- ◆ **EXEMPTION AMOUNT RAISED TO \$2,000,000 (2006)**
- ◆ The new law provides that the unified credit effective exemption amount for estate tax determination be raised to \$2,000,000 per person (2006) and the highest estate and gift tax rate be reduced to 46% (2006).
 - Thereafter, the exemption will gradually increase and the highest estate and gift tax rates will be gradually decreased. See Table A.

Table A (New Tax Law)

YEAR	EXEMPTION AMOUNT	HIGHEST ESTATE & GIFT TAX RATES
2002	\$1,000,000	49%
2003	\$1,000,000	49%
2004	\$1,500,000	48%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007	\$2,000,000	45%
2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010	Estate Tax Repealed Through December 31, 2010	Top Income Tax Individual Rate on Gift Only

NEW TAX LAW (Continued)

ESTATE TAXES NOT PERMANENTLY REPEALED:

- ***REPEAL EFFECTIVE FOR ONE YEAR***

- ◆ The repeal effective in 2010 is NOT permanent. The repeal expires on December 31, 2011 which means that Congress must take up the issue again. Otherwise, the Estate Tax laws as we know them before the repeal will be reenacted.
- ◆ *What do you need to do?*
 - Review Your Estate Plan every 3-5 years
 - Review amounts specified for Trusts and Gifts compared with the applicable law

NEW TAX LAW (Continued)

- ◆ Capital gains are determined by taking the total sale price of an asset then deducting the amount of cost (the basis) of the asset.
- ◆ **OLD LAW:**
THE DECEDENT'S BASIS IN PROPERTY IS STEPPED UP TO THE FAIR MARKET VALUE ON DATE OF DEATH.

NEW TAX LAW (Continued)

◆ **NEW LAW:**

THE DECEDENT'S BASIS IN PROPERTY WILL BE CARRIED OVER TO THE BENEFICIARY

■ **EXCEPTIONS:**

1. the first \$1.3 million
2. additional \$3 million to spouse
3. except when the basis is higher than the fair market value of the asset on the date of death (in which case the fair market value will be used as the basis)



Effective 2010, assets received from a decedent will carry the basis of the decedent. The executor of an estate may increase the basis of assets up to \$1.3 Million; and the property transferred to a spouse can be increased by a total of \$4.3 Million.

NEW TAX LAW (Continued)

- ◆ **GIFT TAX:**

GIFT TAX IS PRESERVED in 2010 and will top off at the highest individual income rate of 35% in the year 2010.

New Tax Laws vs. Your Estate Plan

- ◆ Typical Clause in a Estate Plan for Taxable Estate
 - Gives an amount equal to the Federal Exemption Amount to the Bypass Trust
 - This amount will be raised to \$3.5 million in year 2009 and it is unlimited in 2010
 - If there is no revision, you may be putting too much in trust
 - Especially critical if the beneficiaries of the Bypass Trust and the Marital Trust or the remainder beneficiaries are different
 - There may nothing for one set of beneficiaries

Do I Have Enough Assets to Worry About Estate Taxes?

- ✓ Value of house and other property, cars, boats, other vehicles, stocks/bonds and other securities, art or jewelry
- ✓ IRA's, retirement benefits, 401(k) plans
- ✓ Insurance you own on your life (even though it will pay someone else at your death)
- ✓ Are you the beneficiary of a trust, or do you have the power to control the disposition of other assets not owned by you?

If this adds up to more than \$2,000,000 (2006), you have a taxable estate.

Advanced Estate Planning –

- *Credit Shelter/Disclaimer Trust*
- *Qualified Personal Residence Trust (irrevocable)*
- *Qualified Domestic Trust Family Limited Partnership/Family Limited Liability Company*
- *Irrevocable Life Insurance Trust*

Next Step

Review questionnaires (Link available on www.changlawgroup.com)

Schedule Consultation by calling (888) 350-3282

**From Cover Page: Ms. Chang is certified by the State Bar of California as a specialist in the area of Estate Planning, Probate & Trust. No Certification is available in the State of Washington.*