<u>Fact Pattern No. 2</u>: Leslie Jones

Dear Ms. Jones, this memorandum is intended to memorialize and confirm information received from you during our meeting earlier this month, to describe the current state of your planning and articulate suggestions for the possible update of your planning.

<u>Client background</u>: When meeting with you, we learned that you are 35 year old divorced mother with two (2) children, ages 7 and 9. You are estranged from your former spouse, who you have no contact with or knowledge of his whereabouts and who has never paid spousal or child support. You do not expect to ever receive any financial assistance from him either.

You work as a nurse, and your annual salary is $75,000.00.

1. <u>Client Assets</u>: Your estate consists of the following assets (after liabilities):

- residence: $500,000.00
- 401(k) plan benefits: $20,000.00
- IRA: $ 10,000.00
- cash and savings: $ 10,000.00
- miscellaneous personal property: $ 5,000.00

You have a mortgage of $400,000.00, secured against your residence. You have no other debts other than recurring monthly expenses.

2. <u>Client Goals</u>: Your estate planning goals include the following:

a. You are primarily concerned about the future of her children and their welfare.

b. You have a brother who is married and lives in Montana who would take care of your children if you predecease them before they become adults. However, as described by you, your brother does not handle money well, and you are not certain whether you would want him to handle your children's money. Moreover, it should be noted, his care of your children would entail a move by them or by your brother, or both.

c. You would like to make certain that your children have sufficient money to pay for at least their monthly care, food, and education expenses.

d. Any unspent money that would go to your children you would like held for them until they reach age 25 years old, at which time “they can have whatever remains”.

3. <u>Existing Planning</u>. To date, we have little information concerning what, if any, estate planning you currently have in place.

4. Issues to consider:

a. Existing Planning. It is very important that we have information as to what, if any, estate planning you have in place. Have you made a Last Will and Testament, and if yes, what are its provisions? Have you made a revocable living trust, and if yes, what are its provisions?

While the terms to a Last Wills and Testaments are, by operation of law, modified when a divorce happens, a revocable living trust is not, leaving the possibility that a former spouse can take under it under the document is revoked or otherwise amended.

Review of your divorce decree is recommended, including its provisions regarding the separation of property. Likewise, title to your assets should be reviewed, including how your home is owned. What are your beneficiary designations? A review of your 401(k) plan, its provisions, and your beneficiary designations is also recommended. And information as to when the 401(k) plan came into place, including whether that was before, during, or after your marriage ended.

Given your assets, liabilities, and being the parent of two (2) children, it is highly recommended that you put in place an estate plan, or to the extent that you have one, that it be updated. Generally, existing estate planning should be reviewed periodically (every two (2) to five (5) years and with every major life event, for example, the death of a family member and the birth of a family member).

Moreover, to avoid a potential conservatorship / guardianship, it is always recommended that a power of attorney be in place. Further, it is critical that your family know what medical care you would like. For example, do you want life savings measures or life support? Therefore, a health care poxy and living will, and HIPAA release be in place for each of you, in the event of incapacity and/or a medical emergency. And to make certain that it is respected by third parties, the power of attorney should not be more than 2 years old.

For the reasons stated below, we recommend revocable living trust-based planning, and discretionary sub-trust for the benefit of your children, which can last until the stated age is for distribution. This can provide for creditor protection, and the trust can be named as a beneficiary of your IRA protection (despite the SECURE Act "distribution" and taxation requirements described herein). [The trustee of a discretionary accumulation trust can make discretionary distributions based on a child's spendthrift behavior or if the child is susceptible to drugs, has an unstable marriage, or creditors.]

The above said, your having foundational estate planning in place, including advanced medical directive and power of attorney, is of paramount importance.

b. Divorce. As indicated, divorce does not necessarily sever existing planning. Therefore, to the extent you did any estate planning while married, as stated, your estate planning should be updated. Further, it should also be updated for the other reasons stated above.

When a divorce happens, consideration must be made to unraveling the existing estate plan and separating the interest of the husband and wife. That said, the California Probate Code provides that unless the last will and testament expressly provides otherwise, the provisions of the will providing for the spouse and any nomination of the spouse as executor, trustee, conservator, or guardian are revoked upon the dissolution of the marriage. See California Probate Code §6122. Consistent with California Probate Code §6122, California Probate Code §§5600 and 5601 provide generally for an automatic revocation of: (a) "multiple party accounts" (i.e., joint accounts, payable on death or "P.O.D. accounts", and Totten Trust accounts; (b) transfer on death or "T.O.D." securities and securities accounts; (c) a joint tenancy; and (d) retirement plan beneficiary designations". Further, California Probate Code §5601(a) establishes the general rule that a joint tenancy between a decedent and the decedent's former spouse is severed if, at the time of the decedent's death, the former spouse is not the decedent's surviving spouse, due to the dissolution or annulment of their marriage.

Still, while a divorce does revoke provisions for the former spouse in a last will and testament (including a pour-over last will and testament to a revocable living trust), as stated, a divorce does not automatically revoke a revocable living trust. This is particularly true when the spouses hold certain assets in joint tenancy, or have designated each other as the beneficiary of insurance, annuities, and retirement plans. Still, California Probate Code §5600 may be preempted by Federal law with respect to employer – provided benefits. For plans under the Employee Retirement Income Security Act ("ERISA"), Federal law controls.

It is, therefore, especially important on the dissolution of a marriage to review the beneficiary designations for employer-provided benefits (i.e., your 401(k) plan) and to analyze the specific plan provisions or the law pertaining to them. Likewise, as stated, no automatic revocation of the former spouse rule exists for a revocable living trust, or for insurance or annuity beneficiary designations. Therefore, special attention should be given to plans utilizing revocable living trusts instead of, or in addition to, Last Wills and Testaments, and to ensuring that insurance and annuity beneficiary designations are revised following divorce to make certain that these assets pass as intended.

In keeping with the above, case law suggests that while a divorce decree or property settlement agreement in a marital dissolution action will resolve any marital property rights to insurance proceeds or retirement plan benefits, there will not be a termination of the former spouse as a designated beneficiary of insurance, or retirement plan benefits, or as beneficiary under a Last Will and Testament, absent explicit language to that effect in the order for agreement. Further, for a revocable living trust to be automatically revoked, the trust must be revoked according to its terms, or pursuant to the provisions of California Probate Code §15401 (a)(2). California Probate Code §15401(a)(2) provides that a "trust that is revocable by a settlor may be revoked in whole or in part by… a writing (other than a will) signed by the settlor and delivered to the trustee during the lifetime of the settlor…." Yet, the statute does not apply if the trust instrument explicitly makes the method of revocation the exclusive method of revocation. But, typically, the trust will permit revocation upon the unilateral act of one of the spouses.

In keeping with this discussion detailing the implications of divorce, an important aspect of estate planning is making beneficiary designations and keeping them up to date after life

changes such as divorce (including for retirement accounts such as 401(k)s and IRAs). Federal Law, and more specifically, ERISA governs most pensions and retirement accounts.

If the owner of a 401(k) is single when he or she dies, the assets go to the designated beneficiary, no matter what his or her estate planning documents provide. In addition, the assets will be distributed to the designated beneficiary regardless of any other agreements -- even divorce decrees and other court orders. [It is necessary to review all of your beneficiary designations, to verify whether your former spouse is still named as a beneficiary of any life insurance policies, annuities or retirement plans.]

If a divorcee dies without changing her beneficiary designation and without remarrying, her former spouse will still receive the retirement assets, even if the former spouse has waived his right to receive any retirement assets as part of the divorce agreement and the divorce decrees declares that former spouse should not take. Further, if you have named any minor children from your marriage as beneficiaries and you unexpectedly die, your former spouse will likely become their legal guardian and gain control over their property. Thus, you should consider designating a trust as a beneficiary for your children's benefit, to avoid this situation.

c. <u>Guardians for your Children</u>. You stated that your brother would take care of your children if you predecease them before they become adults. However, you also informed that he does not handle money well, and that you are not certain whether you would want him to handle the children's money. Moreover, he lives in Montana, and therefore his care of your children would entail a move by them or by your brother, or both. He is also married, and how this might impact circumstances (for better or worse) should be considered.

Based on these factors, it might make sense to separate the guardianship from the trusteeship. This potentially entails a long-term trusteeship, and therefore you would want a person with the right skillset and who can serve for the length of the potential trusteeship. Moreover, to the extent you do revocable living trust-based planning, you will want to include within the trust document a provision permitting the trustee’s retention of unproductive property, so that your trustee is not required to sell your home (which might not be advisable for your children by causing even greater disruption), because it is not “productive”. A provision providing that the guardian of your children can demand distributions of income and principle should also be considered, as (particularly given your circumstances here) the guardian may be a different person than the trustee. Given the financial skills of your brother, the extent of the “demand” right should also be considered.

d. <u>Life Insurance and Disability Insurance</u>. Life insurance can play in important role in estate planning, by providing funds to pay taxes, increased liquidity, the fuel of now available funds, and more. It can provide needed funds with the death of a primary breadwinner. Moreover, it is received income tax free. Disability insurance is also very important. When young, you are more likely to become disabled than die. In such event, not only is the person’s income potential impaired, but there is now the cost of caring for a disabled person.

e. Asset Protection. From the information provided, many or most of your assets are titled in your individual name. Moreover, while your individual retirement accounts ("IRAs") is regulated under ERISA, unlike a 401(k), it is not a qualified plan under Federal law. As such, asset protection for your IRA is governed by state law, and in California, your IRA may be seized by creditors. California law shields funds in IRAs that are considered necessary to support the owner (and the owner's dependents) during retirement taking into account all resources that are likely to be available for support, but any surplus may be collected by creditors. The further the owner is from retirement age, the less likely funds may be considered necessary for support in retirement. But, that determination is left to a Court in the event of a creditor action. See Code Civ. Proc. §704.115(e). For this purpose, rollover of a 401(k) into an IRA is not advisable for asset protection purposes.

In addition to the foregoing, a Section 529 Plan makes available a tax-advantaged savings plan that is exempt from Federal taxes and is designed as a way for families to save for college expenses on behalf of a beneficiary (typically, a child). The moneys from a 529 Plan must be used for qualified education expenses in order to be withdrawn tax-free, with eligible contributions possible up to the annual exemption amount ($15,000 for 2021). Five (5) years of gifts possible at one time (for a total of $75,000 for 2021) is possible, but then additional gifts cannot be made into the plan for the ensuing five-year period without gift tax consequences.

Because Federal law considers contributions to a 529 Plan to be gifts made on behalf of the beneficiary, funds kept in these accounts are not considered part of the donor's estate and (if not part of a fraudulent transfer) are safeguarded from the donor's creditors.

That said, in the case of bankruptcy, creditor protection for Section 529 Plans is provided by Federal law, with significant limitations, under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. This act excludes from property of the estate all contributions deposited toward a Section 529 Plan for a beneficiary who is the child, grandchild, stepchild, or step-grandchild of the debtor, and as long as the deposits were made at least 2 years before the bankruptcy was filed and they do not exceed the maximum amount permitted per beneficiary for the program. If the contributions were made between one and 2 years prior to the bankruptcy filing, Section 529 assets are protected up to $5,000 per beneficiary.

In addition to the Federal bankruptcy protections described above, some states have passed statutes that protect Section 529 Plan assets from judgment creditors' claims brought outside of bankruptcy proceedings. Because Section 529 Plans are not Federally regulated, but instead state regulated, each state can set its own requirements. As stated, some states provide protection of Section 529 Plans from creditors, while others only offer creditor protection if the account is in the child's name (not the donor parent's).[8]

However, California is not one of the states that has passed legislation specifying that Section 529 Plans are protected from the creditors of the beneficiary, contributor, and/or the account owner. As such, while Section 529 Plans provide a tax advantaged means to save for your

[8] For example, New York State will protect all assets in a 529 Plan if the account is owned by the child, but only $10,000 if it is owned by someone else, for example, a parent or grandparent.

children's college expenses and some creditor protection, the actual level of creditor protection is uncertain.

f. Probate in California.

While providing a thorough process in California, you may wish your estate to avoid probate for several reasons, including that a typical probate proceeding may last 9 to 24 months, it can be costly due to probate fees being based on the gross value of the probate estate and the fee amounts (which are based on statutory law), and the process being subject to public disclosure. These are considerations in a decision whether to utilize last will and testament-based planning or revocable living trust-based planning (and seeking to avoid probate). Your family (your children) would likely need your moneys to pay life expenses and your estate costs, should you pass, and will not have the privilege of being able to waiting up to twenty-four (24) months without financial difficulty.

Generally, you can accomplish the same goals with either type of planning (that is, last will and testament-based planning or revocable living trust-based planning). However, if fully funded, a revocable living trust-based plan can permit the avoidance of probate. It may also arguably better facilitate disability planning and the update of your planning.

g. Alternatives to Probate in California.

In California, several alternatives to the probate process are available. These include: (i) beneficiary designations for relevant assets (such as, life insurance, transfer on death assets, annuities, 401(k) accounts, IRAs, and the like); (ii) joint tenancies; (iii) community property with right of survivorship; (iv) funded revocable living trust; (v) available statutory methods under the California Probate Code (for example, under section 13100, a Small Estate Affidavit with the declaration can be made); (vi) a Domestic Partner Probate Petition; (vii) an Affidavit of Real Property with Small Value; and (viii) a Petition to Determine Succession for Real Property. However, the Small Estate Affidavit is only available for probate assets with a value in the aggregate of less than $166,000, and the Affidavit of Real Property of Small Value is only available for real property with a value of $75,000 or less. Further, the Petition to Determine Succession for Real Property is available only for property with a value of less than $166,000. As such, many of these methods are available only to a limited pool of individuals.

Here, many of these alternatives do not apply to your circumstances (given the limited asset values for which they are available), and therefore are not available to you. We also recommend our checking your beneficiary designations, and (as stated herein) your consideration of revocable living trust-based planning.

h. General Due diligence. The following questions should be answered, and appropriate action taken.

a. Do you have an updated schedule of assets, fully detailing the above described asset information, including

i. for your bank accounts, (i) the type of account, (ii) the name of institution, its location and relevant account number(s), (iii) in who's name the account(s) is(are) held, and (iv) the approximate value(s) of each account; and

ii. for retirement assets (that is, your 401(k) plan benefits and IRA), (i) a description of the account / institution, (ii) the current beneficiary designation, and (iii) the current beneficiary designation and the approximate balance of each asset?

b. As indicated above, are your beneficiary designation forms completed, and up to date? For your life insurance, your 401(k) plan benefits, and your IRA?

c. Are any of your accounts held with a transfer at death or payable at death designation and direction, including your bank account(s)? If the designated beneficiary predeceased you, will this still accomplish your planning goals?

d. A description of your tangible personal property (miscellaneous personal property). To whom do you wish to leave any specific special assets, for example, your mother's wedding dress, the family bible, and the like? It is said that people have two (2) types of "stuff", special stuff and junk. You will want your special stuff to got to your children and intended beneficiaries.

i. <u>Estate Tax Concerns</u>. With non-taxable estates, you will want all assets to be includable in your estate because they will not be subject to an estate tax (given the currently very high exemption amounts) and will get a basis adjustment under IRC §1014 for capital gains planning purposes. In such circumstances, this is income tax planning, to reduce or eliminate a capital gains tax when assets are later sold. For example, should your home be sold shortly after your death, your estate can realize the sales proceeds without the cost of a capital gains tax (even if your home has significantly increased in value since you purchased it and is therefore sold for a significantly granter amount than the price paid when purchased by you).

j. <u>Long-Term Trusteeship</u>. As stated for your children too, given your own young age (35 years old), there is the potential for a long-term trusteeship. You will want to select a successor trustee who has the right skillset and can serve for the anticipated period of the trusteeship.

k. <u>Long-Term Trusteeship; Separate Shares</u>.

Here, we have a potential long-term trusteeship, given the minor ages of your children. You will want to select a trustee who can serve for the anticipated period of the trusteeship. Moreover, care should be taken in selecting a successor trustee(s). Three (3) options include (1) a from or family member, (2) a professional trustee, and (3) financial institutions with trust departments (for example, Bank of America). You need someone who has good attention to detail, is diligent, can handle the pressure, can handle the details (including making necessary filings, such as tax returns and tax elections), and will be around for the entire period of the trust. While financial institutions may be impersonal and there is a turnover among professionals, they offer the necessary skillset, will be around for the trust term, and are bonded by law – all important considerations. A trusted accountant might also be considered.

When minors are a consideration with planning, the creation of separate shares in the trust for the individual children's benefit is recommended. And you may wish to wait for distributions until the child reaches a certain age, to guard against immaturity. [Here, you have

stated your wish to wait for outright distributions until age 25 years old.] Distributions can be discretionary until the child reaches a stated age, with mandatory outright distributions beginning at a stated age and final distributions at a stated age.

You might also provide for discretionary distributions for "good reasons", such as the purchase of a home or business. Alternatively, there is the possibility that a child might develop a drug or alcohol problem, spendthrift problems, a disability, or attract a significant creditor. Therefore, there are reasons to be careful with requiring mandatory distributions to them.

l. Asset Protection Planning. Asset protection is very important to estate planning, as estate planning typically involves transfers of assets (to a revocable living trust or a irrevocable living trust, grantor trust, or business entity). That said, planning for a potential claim is permissible, but not a fraudulent transfer following when a claim (including potential claim) arises – which is not permitted under law.

That said, the number one asset protection planning device is personal liability insurance, to make certain that you have sufficient liability insurance. This includes having an umbrella policy. Most liability claims are under $1,000,000, which insurance can protect against. Umbrella policies are available in the event a liability exceeds the underlying policy amount (for example, $1,000,000 of coverage), and they can be obtained up to the amount of $5,000,000. Because such liability is infrequent, umbrella policies are generally very inexpensive (often only approximately $400 to $500 per year).

Further, California law does not permit the creation and transfer of assets to a self-settled trusts to hide them from creditors, and the transfer of assets to a revocable living trust leaves the transferred assets subject to the trustmaker's creditors.

While your IRA is regulated under ERISA, unlike your 401(k) plan benefits it is not qualified plans under Federal law. As such, the IRA's creditor protections is governed by state law, and in California, may be seized by creditors. California law shields funds in IRAs that are considered necessary to support the owner and the owner's dependents during retirement taking into account all resources that are likely to be available for support, but any surplus may be collected by creditors. The further the owner is from retirement age, the less likely funds may be considered necessary for support in retirement. But, that determination is left to a Court in the event of a creditor action. See Code Civ. Proc. §704.115(e). For this purpose, rollover of a 401(k) into an IRA is not advisable for asset protection purpose.

The above said, asset protection measures on their own are no replacement for insurance. However, if strategically integrated, the best protections can be realized.

m. Planning for digital assets – It is encouraged that you organize and inventory your digital assets, listing your various accounts, usernames, passwords, and personal verification questions necessary to access them, as well as any password necessary to access your personal computer, smart phone, or other hardware devices. You should also consider taking advantage of any legacy access services provided by used platforms (for example, Google, Amazon, and Facebook). And you should consider specifically granting fiduciary powers of administration over

your digital assets, and consent to disclosure of the contents of electronic communications to fiduciaries.

n. Retirement assets — Retirement assets include qualified plans (401(k) plans and 403B plans) that are taxed only when money is withdrawn, at the ordinary income tax rate (not capital gain) as the money deposited was ordinary income. These retirement assets are includable in your taxable gross estate. Pursuant to the SECURE Act (as described herein), a "stretch" is no longer available to your beneficiaries, as was permitted under prior law.

With regard to retirement assets, a first question is whether the asset is an ERISA qualified plan. As stated elsewhere, while IRAs are regulated under ERISA, they are not qualified plans under Federal law. For ERISA qualified plans, there are two (2) types of designated beneficiaries (an individual and a trust meeting certain requirements), with a different set of rules for each. To qualify as a designated beneficiary, the trust (i) must be valid under state law, (ii) must be irrevocable as of the date of the plan participant's death, (iii) must have identifiable beneficiaries as of the year following the plan participant's date of death, and (iv) must have an available copy of the plan. If satisfied, the trust qualifies as a designated beneficiary.

You will want your beneficiaries to be designated beneficiaries. If not a designated beneficiary (an estate or a charity), distributions must be made within five (5) years of death.

If an individual, there are three (3) options for distributions – (i) a lump sum distribution, (ii) distributions made in installments but subject to the SECURE Act requirements, and (iii) if the designated beneficiary is a spouse, that person can roll the monies over into his or her own IRA (a spousal rollover IRA) and start all over again with required minimum distribution beginning when the money is distributed to the spouse's plan. [That said, the SECURE Act changed the minimum distributions rules, including when distributions must be started (now, as stated above, by 72 years old).]

By way of background, under the Setting Every Community Up For Retirement Enhancement (the "SECURE Act"), except for Eligible Designated Beneficiaries (the "EDB"), the life expectancy method is no longer the default method for determining required minimum distributions ("RMDs"). The new rules require RMDs to be distributed to non-EDBs beginning at the plan participants death, the EDB's death or the minor child's attaining the age of majority. [Prior to the SECURE Act, the Stretch IRA planning technique to optimally dribble out RMDs over the designated beneficiary's life expectancy, but it is no longer available, and in its place a 10-year (versus life expectancy) pay-out is now required.]

The SECURE Act and its 10-year payout requirement commence once the age of majority (age 18) is reached. Prior to then, the minor child is an EDB and tell majority, using the life expectancy method for the pre-majority.

Importantly, every designated beneficiary (an individual or a qualified trust) other than a spouse, a minor, or a chronically ill or disabled designated beneficiary, must now take out over a ten-year period from the death of the plan participant all monies from the qualified plan. As stated, no "stretch" over the beneficiary's life expectancy is now available, except (i) spouses may

still stretch over their life expectancy, (ii) minors must start taking a distribution within ten (10) years of turning the age of 18 years old, and must take out all monies within 10 years (that is, by age 28 years old), and (iii) disabled or chronically ill persons can still get a stretch based on their life expectancy. Moreover, as indicated above, if the beneficiary is a non-designated beneficiary (that is, an estate or a charity), the beneficiary is left with the five-year rule. The biggest issue, therefore, is elimination of the stretch.

In light of the above, you may wish to create sub-trusts for the benefit of your children under your revocable living trust and to name your trust as beneficiary, rather than naming your minor children individually. [If an accumulation trust, your successor trustee could make or not make discretionary distributions based on existing conditions, such as whether the child exhibits spendthrift behavior or is susceptible to drugs, unstable marriages or creditors. This is opposed to the conduit trust, which requires the RMDs and other plan distributions to be distributed outright to the child once the child reaches the age of majority. Accumulation trust are preferable to conduit trusts for asset protection purposes.] While moneys must be taken out of the plan within the 10-year period and be subject to tax, they need not be distributed from the trust to the beneficiary. Therefore, use of a discretionary accumulation trust can still be utilized for creditor protection and spendthrift protection purposes, to keep all of these moneys held in trust until your children reach age 25 years (the age you mentioned) or beyond, if distributed at a later age.

5. Recommendations

First, it is recommended that foundational estate planning be put in place, including the naming of guardians for your minor children under a last will and testament. For the reasons described above, we recommend that you make a revocable living trust with a pour-over last will and testament. You can serve as trustee of your trust, but thought should be given as to who might serve as a successor trustee and who should serve as your executor under the pour-over last will and testament. Further, consideration should be given as to who could serve as a successor trustee and contingent executor. In addition, a general durable power of attorney, healthcare proxy and living will, and HIPAA release are recommended, to plan in the event of your capacity and thereby avoid the need for a conservatorship proceeding. In making these documents, the below-described trust provisions should be considered.

As indicated above, a complete Schedule A of your assets should be prepared. In doing so, all beneficiary designations should be considered and confirmed (retirement assets, life insurance, bank accounts, and more (as applicable), and all payable on death and transfer on death designations). It is important to make certain that your former spouse is not mistakenly allowed to take because designations were never updated. Importantly, transfer of fee title to your residence to a Revocable Living Trust does not disqualify eligibility under either IRC §121 or IRC §1014, or cause a reassessment of the property.

With regard to your children, as mentioned above, you will want to designate guardians in each of your Last Will and Testament, in the event something were to happen to you. As education savings is a goal, as you save and your assets increase you might consider establishing and your making contributions to Section 529 Plans.

As stated, thought should be given as to whom might serve as a successor trustee. While your brother is willing to help, if need be, you have stated that he does not handle money well. That said, if a friend or family member is thought to be qualified, a discussion with her is suggested, to learn if she is prepared for such a responsibility – given the duties required, details involved, the possible length of the trusteeship, and the potential liabilities. Alternatively, a professional trustee or financial institution with a trust department might serve. Either could handle the necessary details (including making necessary filings, such as tax returns and tax elections), and will be around for the entire potential period of the trusteeship, and each is bonded by law.

Who would serve as your healthcare agent is critical decision. The person selected should be someone who can make tough emotional decisions, and he or she must be prepared for these responsibilities. The level of communication your agents should have with family members in making decisions should also be considered.

Because your Roth IRA is regulated under ERISA, unlike your 401(k), for asset protection purposes rollover of a 401(k) into an IRA is not advisable for creditor protection purposes. Conversely, converting a 401(k) to an IRA provides more options for designated beneficiaries.

Moreover, your obtaining additional personal insurance (including an umbrella policy) should be considered. Such insurance would provide potentially needed protection, and at an affordable cost. It is also recommended that you obtain term life insurance for an extended period (20 to 30 years) too, with your revocable living trust named as beneficiary. For an inexpensive cost (likely just a few hundred dollars annually), this could provide much needed funds for your children should you die young, with (during the period of the trust) these moneys safeguarded by being in the care of your successor trustee for your children's benefit. Further, your obtaining disability insurance might be considered as well, as at your young age disability is conceivably a greater risk (and risk for your family) than your death.

When meeting, you also stated that you are considering remarriage, but wish to make certain that your children are taken care of first if you were to predecease your new husband. If that is the case, it is all the more critical to review and revise your estate plan, to protect your children and prevent the unexpected from happening (and possible dispute).

Both you and your potential new spouse should make an inventory of your assets and debts, listing all of your financial-related accounts (savings, checking, and investment), real estate, and any other personal assets. Your existing wills, trusts, powers of attorney, health care directives, and other estate planning documents should be reviewed. With a good inventory of your assets and debts, you can assess what assets need to be retitled, and better review your beneficiary designations. The handling of any existing debts brought into the relationship should be determined prior to commingling any assets with a new spouse. [As you retitle assets, be careful not to make yourself liable for debts your new spouse is bringing into your second marriage. In such circumstances, it may be wise to keep your accounts separate.]

The inventory can help you decide if a prenuptial agreement may be necessary to protect your individual financial interests (and those of your children). For example, a prenuptial agreement can be utilized to waive your respective rights to each other's property, and to define

premarital assets and debt. An ERISA qualified a Spousal Waiver of your 401(k) assets might be warranted.

In keeping with the above, you should discuss with your future spouse how each of you will factor into the estate plan of the other. Given you concerns with protecting your children, you may wish to name your children as beneficiaries under a revocable living trust, or to create a family trust that provides support for your family but limited access by your new spouse to principal and distributions -- to instead preserve them for the children. [Qualifying the trust as a grantor trust under IRC §678, so it is taxed at the beneficiary's tax rate rather than the compressed trust tax rates is recommended.] You may wish your new spouse to waive right to your probate estate too.

You might also wish to keep your property as separate property, to the extent possible, to prevent its transmutation to community property whereby the new spouse would have rights to the property (and potentially not share it with your children). You might name your children's sub-trusts as beneficiary of your IRA. [Remember, a new spouse will have the ability to name anyone he pleases as a new beneficiary, once you are gone. Even if promises are made, those promises can be broken after one spouse is deceased.]

When naming new beneficiaries, as indicated above, be aware that your new spouse may have mandatory rights to certain assets, such as qualified retirement plans. Even if someone else is named as a beneficiary, such as a child from a prior marriage, you will have to ask your new spouse to waive these rights in writing. Otherwise, upon your death, a court might assign your qualified retirement plan assets to your spouse, even though your children are named beneficiaries of your qualified retirement benefits. As such, obtaining a consent to waive these benefits from your new spouse is critical.

Under ERISA, if the owner of a retirement account is married when he or she dies, his or her spouse is automatically entitled to receive 50 percent of the money, regardless of what the beneficiary designation says. If another person is the designated beneficiary, the spouse will receive 50 percent of the assets and the designated beneficiary will receive the other 50 percent. A spouse always receives half the assets of an ERISA-governed account, unless he or she has completed a Spousal Waiver and another person or entity (such as an estate or trust) is listed as a beneficiary. A spouse can forgo his or her right to 50 percent of the account by properly executing a Spousal Waiver. However, generally a Spousal Waiver is not permissible under ERISA unless the spouse is at least 35 years old, depending on the type of retirement plan.

These rules can cause problems when the owner of a retirement account remarries. Often, the owner will change his or her beneficiary designation upon divorce and name the children as the designated beneficiaries. If the owner later remarries, however, 50 percent of the retirement assets will go to the new spouse instead of the children, even if the new spouse is not added as a beneficiary.

The above said, in contrast to 401(k)s, as stated above, IRAs are controlled by state law, which does not automatically grant spouses beneficiary rights. A surviving spouse (or registered domestic partner) is not automatically entitled to "inherit" money from a deceased spouse's IRA. If the account owner designates someone else as the beneficiary (for example, the children of their first marriage), then those persons will be entitled to the IRA moneys. By rolling a 401(k) into an

IRA, an owner gains flexibility to name anyone as the designated beneficiary, with or without a spouse's consent. Federal courts have confirmed that spouses do not have ERISA rights with IRAs, and so for these purposes (as opposed to asset protection planning), you may wish to roll your 401(k) savings into an IRA if the occasion to do so every arises.

These above issues should be considered, and discussed further, as needed.

6. Recommended Trust Provisions

a. Because the trust would survive you, it is recommended that you avoid using the word “revocable” in the name of the trust, as a trust becomes irrevocable upon the trustmaker’s death.

b. The effective date of the trust should be immediate, to be effective immediately in the event you became incapacitated, as the trust will provide for you during your lifetime (including during a disability.) This can help avoid the necessity of a conservatorship, by providing provisions for your care.

c. Intentions – Under the California Probate Code, a trustee is required to follow the intentions of the trustmaker. It is therefore helpful and recommended to put into the trust instrument the trustmaker’s intentions, particularly any particular wishes.

d. Trustee -- With the revocable living trust, the trustmaker should generally be the trustee until such time as he or she has become incapacitated or has passed away.

e. Successor Trustee -- You should not pick someone just because he or she is a friend or family member. You need someone who has good attention to detail, is diligent, can handle the pressure, can handle the details (including making necessary filings, such as tax returns and tax elections), and will be around for the entire period of the trust. [Note, you have minor children, and so there may be a long-term trusteeship, or a long-term trusteeship in the event of your own disability.] You will need someone ready, willing, and able to manage the trust assets, and who can say “no” when appropriate and not be coerced by beneficiaries.

f. Powers of the Trustee –

i. The powers of the trustee should be broad, to address life changes and changes in the law changes, to permit the trust to grow and change as the trustmaker’s life changes. The power to amend and revoke the trust is critical.

ii. The power of the trustee should include the power to invest property. California has the uniform prudent investor act, which under modern portfolio theory requires diversification, unless the trust instrument provides otherwise. If the trustmaker is heavily invested in a single class of assets (for example, real estate), this can cause a problem. In such circumstances, the trustee will have to liquidate assets, to diversify.

iii. Power over unproductive property – by granting the trustee power to retain or acquire unproductive or under productive property, this can prevent the forced sale of the family residence (even though it is not productive property).

iv. The power to operate a business -- the trustee has the power to hold and operate any business or enterprise that is or becomes trust property. This is an important provision, as trust generally do not have the power to operate a business.

v. Power to determine, for trust purposes, whether moneys are income or principle.

vi. The discretion to make distributions of income and principal, and the standard for distributions (i.e., a five by five power or "health, education maintenance and support", which includes more than just medical bills and permits consideration of the beneficiary's standard of living, or a much broader "comfort, welfare, and happiness" standard).

vii. Payments for legally incapacitated persons, which permits the trustee to give the guardian (rather than the incapacitated person) payments.

g. Funding (Schedule A) -- A trust is not valid under law unless it has assets. It is therefore critical to identify the trust assets by listing them on a Schedule A to the trust. Applicable case law (Estate of Heggstead and Estate of Ukkstead) holds that a general assignment is acceptable (the attachment of a schedule of assets to the instrument and reference to it in the instrument) to qualify the scheduled assets as trust assets. Thereafter, if necessary, a Heggstead petition can be made to the Court for a Heggstead order permitting, i.e., the filing of a new deed, which generally can be obtained within sixty (60) days. The asset schedule must be up to date, with the schedule being one of the most important sections of the trust.

h. Funding with Additional Assets – a provision permitting additions to the trust is recommended for a revocable living trust (which is generally amendable), to permit the addition of assets to the trust. This permits flexibility, and is different from an irrevocable living trust, where the addition or subtraction of assets is not permitted.

i. Revocation and Amendment

i. Because at some point you may become incapacitated, it is recommended that you (i) grant a successor trustee the power to make distributions during your lifetime and (ii) articulate your rights to distributions in those circumstances.

ii. It is suggested that this be paired with designated powers under a power of attorney, to avoid the need for a conservatorship.

iii. It is also recommended that you allow the exercise of changes to the trust by third parties, in the event you are incapacitated. Correspondingly, among the powers given in the power of attorney, the agent should be authorized to amend the trust, for example, because of changes in the family and changes in tax laws. [Absent the power of attorney, a petition to the probate court for appointment of a conservator would be necessary, to permit changes in the trust in the event the trustmaker's disability. Under California law, if you put the provision in the trust, you also need to put it in the power of attorney document.]

j. Distributions – It is recommended that you give the trustee the power to defer distributions, to give the trustee a reasonable period of time to make distributions and not be forced to make distributions (for a 6-month to 9-month period). This will address circumstances when beneficiaries immediately start to spend money and therefore demand distributions.

k. Incapacity and Disability Planning – It is suggested that you have a provision providing that in the event of your in capacity, the agent under a power of attorney can demand distributions of income and principle. This will be particularly important if the agent is a different person than the trustee; and it can avoid the need to petition the court for appointment of the conservatory. The provision should also recognize the agent acting for you under a valid healthcare directive or comparable instrument.

l. A provision providing that the guardian of your children can demand distributions of income and principle should also be considered, as (particularly given your circumstances here) the guardian may be a different person than the trustee.

m. Debts -- A provision directing the trustee to pay debts (including taxes) is recommended, to pay taxes, debts, expenses of administration, and the like. With that, distributions

can be free and clear of debts, and you can prevent the possibility of creditors seeking to collect from your beneficiaries.

n. Account – The time period for objecting to account, if stated in bold language, can be reduced from three (3) years to 180 days, with everyone getting a prompt accounting. It is recommended that such language be stated, but that the right to an accounting <u>not</u> be waived.

7. <u>Summary</u>

We have reviewed the information you have provided, including your articulated goals. In light thereof, we recommend updated of your foundational estate planning, by the making of a revocable living trust with a pour-over last will and testament a general durable power of attorney, healthcare proxy and living will, and HIPAA release. In making these documents, certain provisions should be considered. Moreover, thought should be given as to who might be qualified to serve as your successor trustee, and as guardian of your children.

First, it is recommended that your foundational estate planning be updated. For the reasons described above, as stated, we recommend that you make a revocable living trust with a pour-over last will and testament (naming guardians for your children and pour-over unfunded assets into your trust). You can serve as trustee of your trust, but thought should be given as to who should serve as successor trustee and who should serve as your executor under the pour-over last will and testament. Further, thought should be given as to who could serve as successor executor. In addition, a general durable power of attorney, healthcare proxy and living will, and HIPAA release are recommended, to plan in the event of your capacity and thereby avoid the need for a conservatorship proceeding. In making these documents, the above-described trust provisions should be considered. With regard to asset protection, your obtaining additional personal insurance (including an umbrella policy) should be considered.

Your obtaining term life insurance for an extended period (20 to 30 years) is recommended too, with your revocable living trust named as beneficiary. Further, your obtaining disability insurance might be considered as well.

Additional thought should be taken, in the event you prepare for remarriage, to make certain that your assets are protected for the benefit of your children. Your revocable living trust can make your children your ultimate beneficiaries, and you can make your children's sub-trusts the beneficiary of your 401(k) and IRA assets. To accomplish this, a prenuptial agreement and waivers from your new spouse (an ERISA qualified a Spousal Waiver and a waiver of rights to your probate assets) must be obtained.