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March 22, 2016

## What's Involved In A Living Trust For A Married Couple?

### 1. Documents Involved.

- (i) "Pourover" Wills For Each Spouse.
- (ii) The Trust.<sup>1</sup>
- (iii) Trust Certificate.
- (iv) "Blanket" Assignment Of Assets.
- (v) Durable Power Of Attorney For Asset Management For Each Spouse.
- (vi) Advance Health Care Directive For Each Spouse.

### 2. Documents Explained.

#### 2.1. "Pourover" Will.

It provides that any of your assets not already in your trust at your death are transferred to the trust. The "Blanket" assignment (discussed below) makes it virtually impossible for assets to not *already* be in your trust at your death. Therefore, "pourover" Wills are usually unimportant. They become important if you have minor children because in the Will you nominate guardians. For people without minor children, the Will will almost never come into force.<sup>2</sup>

#### 2.2. The Trust.

It provides "who gets what" and how they get "it" upon your death. It also provides for your care if you become incompetent. This is a "Will substitute". It may create "testamentary" trusts (trusts that come into existence on your death). One testamentary trust may be a marital trust (holds assets for your spouse). Another might be to hold assets for your spouse and preserve your lifetime exclusion ("bypass" trust, also called the "exemption" trust). Also, testamentary trusts may be created to hold assets for your children and other heirs until they get to the ages you have set for them to own the assets outright.

#### 2.3. Trust Certificate.

An abbreviated version of the trust designed to give to financial institutions and escrows when they ask for a copy of your trust. They are not entitled to a copy of your trust as it has private information which is none of their business.

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<sup>1</sup> Sometimes called a "family trust" or a "revocable trust" or an "inter vivos trust".

<sup>2</sup> For a Will to come into force it must be entered into probate, and none of our clients' estates have to go through probate.

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### **2.4. "Blanket" Assignment of Assets.**

It declares that you are holding all of your assets as trustees of your trust. That works as to personal property to avoid probate. For real property – which means anything where your name appears on the title<sup>3</sup> – it must be listed in the assignment by (i) address; (ii) A.P.N.;<sup>4</sup> or (iii) legal description. This is an important document since it virtually guarantees that no probate will be needed (at least as to California assets).<sup>5</sup>

### **2.5. Durable power of attorney for asset management.**

This authorizes someone to act on your behalf for financial matters when you are mentally unable to do so.<sup>6</sup> This supplements the trust so you should consider naming as your agent the same person(s) you name as successor trustees in your trust.

### **2.6. Advance Health Care Directive.**

This is the California Medical Association's form for you to authorize someone to make health care decisions for you in case you become unable to do so. You can also elect to become an organ donor. There is also a short California supplement since California did not conform to HIPAA.<sup>7</sup>

We also provide you with a copy of the POLST.<sup>8</sup>

## **3. Estate Planning vs. Estate Tax Planning.**

"Estate planning" means "who gets what and how do they get it when you are gone?" That is different than "estate **tax** planning." Estate **tax** planning addresses how to reduce the value of your assets so that there is little or no estate tax. We first do the "estate planning" and, once that is done, move on to "estate **tax** planning" if your estate is large enough to need that type of help.<sup>9</sup>

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<sup>3</sup> Most people do not own real property directly (other than their principal residence). Instead, they own membership interests in LLCs or partnership interests in partnerships that own real property. Membership interests in LLCs and partnership interests in partnerships are *personal* property which are covered by the "blanket" assignment, meaning they do not have to be individually identified.

<sup>4</sup> Assessor's Parcel Number.

<sup>5</sup> This document has the force of law due to Estate Of Heggstad, by California's 1st App. Dist. Ct., 16 CA 4th 943 (6/21/93).

<sup>6</sup> Financial institutions do not like to respond to powers of attorney. What they want is the comfort of a court order. So if you are incompetent and your children present a durable power of attorney to a bank, you can expect that it will be a struggle for your children to get the bank to recognize their authority under the power of attorney. To try and minimize that it is best to meet with the financial institution in advance and give it a copy of the power of attorney.

<sup>7</sup> The Health Insurance Portability and Accountability Act of 1996, which is federal legislation that provides data privacy and security provisions for safeguarding medical information.

<sup>8</sup> Physician Orders For Life-Sustaining Treatment, a form you can only fill out in the presence of your physician. It allows you to choose treatments that you want or do not want.

<sup>9</sup> Currently each person can pass \$5,450,000 free of estate tax.

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### **4. Decisions Required.**

Estate planning can be divided into many topics. However, we will focus on these:

- Fiduciaries.
- Spousal planning.
- Children.
- Other beneficiaries.

#### **4.1. Fiduciaries.**

##### **4.1.1. In General.**

The word "fiduciary" comes from the Latin root "fides" which means trust.<sup>10</sup> There are three types of fiduciaries:

- (i) executor (the person who runs the Will);
- (ii) trustee (the person who run the trusts); and
- (iii) guardian (the person who has control over minor children).

A Will does not go into effect unless there is a probate. In California the estates of people with fully funded family trusts do not go through probate. So, although you will have a document called a "Will", it will not go into effect (unless you have minor children). So, although you will nominate someone to be the "executor," that person will never act as the Executor. Probably that same person will be your choice as trustee and will act in that capacity. In other words our focus will be on finding the right person or persons, which might include a bank or trust company, to be the trustee or co-trustees.

##### **4.1.2. Timing.**

There are two time periods in which someone can act as trustee:

- (i) when you are alive but incompetent; and
- (ii) after you are dead.

##### **4.1.3. Problem With Children As Trustees.**

**While you are alive** but incompetent (which means you are both alive but incompetent, or when one of you is dead and the other is alive but incompetent), you need someone who will spend the assets of your estate for your care without concern about preserving it for your heirs. For that reason children are not a good choice as trustee.

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<sup>10</sup> That's why dogs are often named "Fido."

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**After you are both dead**, again children are poor choices as trustees for several reasons. If you pick one child as trustee over all the children, then the others will hate the child selected as trustee. It doesn't matter how well your children get along while you are alive; naming one child as trustee is a formula for disaster. Similarly, naming all of the children as co-trustees is a formula for disaster.

### **4.1.4. Independent Third Parties.**

The safest approach is to name an independent third party. Some people are blessed and have one perfect person - a parent (of one of you), a sibling, a cousin, nephew, business partner - who would be an ideal choice as trustee were you to pass away prematurely (meaning before the age at which the assets are to be distributed outright to the children - more on that later).

### **4.1.5. Co-Trustees.**

If you don't have one perfect person you may have two imperfect people to act together as co-trustees. Or you may have a person who is perfect to act in place of the two of you when it comes to making family-type decisions, but isn't good with money. In that case you might make that person a co-trustee with a national Blue Chip trust company<sup>11</sup> or a well-respected local trust company.<sup>12</sup>

In those situations the institution is the "administrative trustee" (handling investments, accounting, cutting checks, filing tax returns) and the individual determines whether the child needs \$100,000 for a car or \$40,000 for a car.<sup>13</sup>

## **4.2. Spousal Planning.**

### **4.2.1. Larger Estates.**

In an estate of \$11,000,000 or more, or any other size which is likely to be taxable, on the first spouse's death, that spouse's half of the estate goes into two irrevocable trusts. One is called the "bypass" trust.<sup>14</sup> It contains the amount that can pass free of estate tax or free of gift tax<sup>15</sup>. In estates likely to be subject to an estate tax, the exclusion at death will usually have already been reduced to some extent due to gifts made during life (due to sophisticated estate tax planning). However, that is for another discussion.

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<sup>11</sup> Examples include Northern Trust; Wilmington Trust; U.S. Trust (Bank of America); J.P. Morgan; Wells Fargo; and Deutsche Bank.

<sup>12</sup> Examples include City National Bank and Whittier Trust.

<sup>13</sup> This topic is inter-related with the topic of distributions to the children because there are situations in which the children may have powers over the fiduciaries at certain ages.

<sup>14</sup> Other names for that are the "exemption" trust; the "exclusion" trust; the "family" trust (confusing name); the "B" trust; and the "credit shelter" trust.

<sup>15</sup> \$5,450,000 in 2016, increasing each due to the cost of living.

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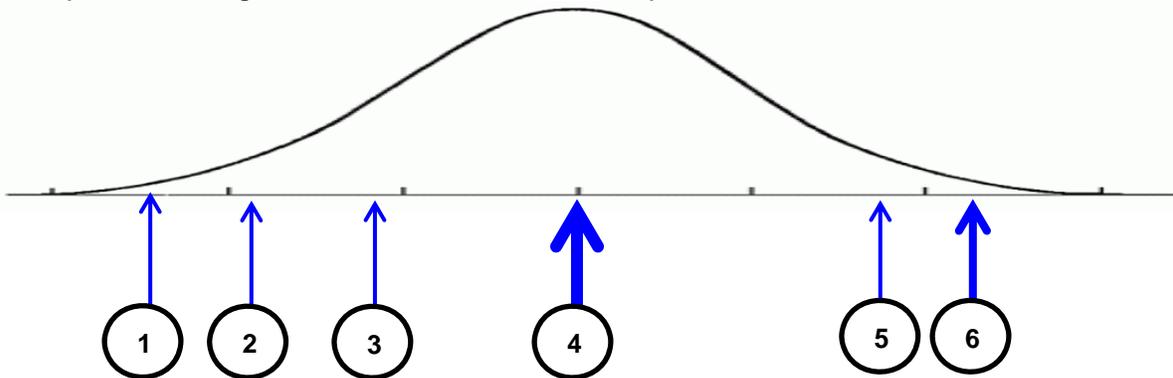
The other trust is the "marital" trust.<sup>16</sup> It contains the rest of the deceased spouse's half of the estate. All of this trust's income must be paid to the surviving spouse. Usually this trust permits the principal to be used to maintain the surviving spouse's standard of living.

### 4.2.2. Smaller Estates.

For estates under \$11,000,000, or unlikely to be subject to estate tax,<sup>17</sup> usually the first spouse's assets go into a marital trust. The surviving spouse can choose to file an estate tax return<sup>18</sup> to get to use the first spouse's lifetime exclusion during the survivor's lifetime or at death. The survivor will do that if the survivor thinks the estate will grow large enough by the survivor's death to need that amount of exclusion to avoid an estate tax.

### 4.3. Distributions To Children.

There are two polar extremes when it comes to how to handle distributions to children after both parents are gone. And there is a bell shaped curve in between.



- 1 **Blow It.** One extreme: everything outright to the children as soon as the parent (or surviving parent) dies. Let the children blow all the money and get on with their lives.
- 2 **Beneficiary Directed Trust.** When the beneficiary gets to a certain age, e.g., 35, the trustee contributes the trust's assets into a single member LLC and names the beneficiary as the non-member manager of the LLC. That gives the beneficiary the ability to directly manage the investment of the trust assets. The beneficiary may also be given the ability to remove the trustee and name a new one.
- 3 **Lapsed Years.** An example would be the distribution of 1/3<sup>rd</sup> of the assets to each beneficiary 5 years after the surviving parent's death; 1/2 of the balance 10 years after the surviving parent's death; and the balance 15 years after the surviving parent's

<sup>16</sup> Sometimes called the "QTIP" trust or the "C" trust.

<sup>17</sup> You might have a \$25,000,000 estate. But if \$15,000,000 of it is going to charity, there will almost certainly not be an estate tax due to the combination of the charitable deduction and the lifetime transfer tax exclusion.

<sup>18</sup> IRS Form 706.

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death. Each child is treated equally: they all get their distributions on the same date. It works well when the children are of similar age, e.g., 28, 30 and 32. It does not work well when one of the children is significantly younger than the others.

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**Birthday Clause.** The vast majority choose some variation on a "birthday clause." For example, the children get the principal one-third at ages 30, 35 and 40. Or 10% outright at 30 and the balance one-third at 35, 40 and 45. The idea is that the parent wants the children to, at some point, get the money, and have the trust end. The parent is not trying to have the assets pass on to future generations. The parent is trying to protect the children, to some extent, from their own mistakes and creditors. However, at some point the children will have to make it on their own.

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**Incentive Distribution.** Some few people like incentive distribution clauses. For example, starting at age 25 the trustee will distribute an amount equal to the "total income" line on the child's IRS Form 1040. Or, the trustee will distribute to the child, at age 30, an amount equal to what the child is able to show as the child's net worth according to a certified financial statement prepared by a certified public accountant.

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**Complete Discretion.** An increasing percentage of parents want the trustees to have complete discretion as to both principal and income distributions. This is to (i) minimize the estate and generation skipping transfer tax and (ii) maximize the protection of the assets from the heirs' creditors (and from the heirs' own bad decisions). If the trust is created in a state like Nevada (365 years) or Delaware (unlimited duration), the trust can continue for the benefit of future generations ("**Dynasty Trust**").

### 4.4. Other Beneficiaries?

Having said that everything is going to the children when you are both gone, is there some: (i) religious institution; (ii) disease related charity; or (iii) niece, nephew, aunt, uncle, housekeeper, friend to whom you wish to leave \$10,000 or so? These "specific bequests" are intended to be dollar amounts that are unburdened by what would otherwise be their share of estate tax or expenses.

### 5. Other Topics.

This is just an introductory discussion. You might need to provide for aged parents; you might want to make a large charitable bequest. There are other possibilities.

### 6. Conclusion.

Please write down your choices and questions so that you have them at our meeting.