ESTATE PLANNING

by John Ambrecht, JD, MBA, LLM

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Look Out of State to Secure Your Privacy and Assets

Many individuals who have significant assets to pass on to their children and other beneficiaries are aware that, in California, a trust generally provides more privacy than a will. Unfortunately, however, California is among the worst states when it comes to ensuring the privacy of trust provisions and, whether you use a trust or a will, the implementation of your final wishes.

In terms of privacy, Probate Code section 16061.7 requires a trustee to notify *all* of your heirs and named trust beneficiaries (including contingent beneficiaries) within 60 days of your death and in the event that the trustee changes any time after you die. The amounts of your bequests to individuals and charitable organizations – and the terms of your trust and the value of your estate – can become known to all heirs and beneficiaries. If any heirs or beneficiaries disagree with your decisions, they have 120 days to contest your trust (or will) and sue your estate after the notice is received. In California, you cannot waive this notice requirement. That can be important because, though your trust becomes "irrevocable" upon your death, in California it is not necessarily irreversible.

On that latter note, if provisions of your trust are contested, California judges tend to use the concept of equity, and maybe their own values and experience, to determine what is "fair" to beneficiaries. This often prompts them to be guided more by their perception of beneficiaries' needs than by the testator's written intentions. As a result, your final wishes may not be followed.

In addition, California trustees are responsible (and liable!) for every decision regarding assets in a trust, even when they follow your written provisions and the guidance of professional advisors. This can, albeit indirectly, give more control and collection ability to beneficiaries and creditors than to your designated trustee(s). A recent California case put the executor of an estate through a three-year legal nightmare when four large nonprofits sued for more money than they had received from an estate. They won little more because the estate wasn't worth what the suing attorney alleged, yet the suit created needless legal fees and wreaked havoc on the executor and her family.

Legal fees often drain large portions of contested estates. A recent local case generated over $1 million in fees for a trust valued at about $8 million. In that case, the judge ordered a California trustee to pay the legal expenses of an ex-spouse who was never intended to be an indirect beneficiary, but who did sue for a share of the estate for his legal fees.

What to Do?

If you reside in California, use a trust rather than a will *and* choose a trust-friendly state – one that protects privacy and follows testators' written intentions. Historically, the most trust-friendly states have been Alaska, Delaware, Nevada, and South Dakota. Those states have been joined by others competing for trust business, including Hawaii, Mississippi, Missouri, New Hampshire, Ohio, Oklahoma, Rhode Island, Tennessee, Utah, Virginia, and Wyoming.

The preferred state for your trust will depend on your estate planning goals, the type of trust(s) you use, and the statute and case law in that state. Given the complexity of the laws and their potential impact, you will likely need professional assistance, particularly if you own a successful business or high net worth estate.

In a trust-friendly state, you can potentially secure the following advantages:

1) *Increased privacy:* For a variety of reasons, many testators want to keep the value of their estates and bequests, and provisions in their trusts, private – even from other heirs and beneficiaries. A number of states limit the information in trust documents which must be shared with heirs and beneficiaries. This provision works particularly well with children from prior marriages and helps avoid potential conflicts with the new spouse!

2) *Greater control:* The latitude and liability of trustees regarding investments, transactions, disbursements, and other matters regarding your trust can be affected by choice of state. Even banks and other institutional trustees have less fear of liability in trust-friendly states. In a *directed trust* you can designate a committee, which can include professional advisors, to direct the trustee's decisions on investments, disbursements, and other transactions. However, California (among other states) has no directed trust statute and affords less protection for directed trustees.

3) *Better treatment of family businesses:* A family business can be owned by a trust, but in California the trustee could be required to diversify the trust assets even if the requirement to diversify is waived in the trust document. Thus, a trustee could face personal liability if the family business is the only asset or the largest asset in the trust. That liability would not exist, for example, in South Dakota. Absence of that liability frees the trustee to hold the business instead of diversifying the trust assets, and frees the business owners and managers to address business issues instead of a trustee's concerns.

4) *Improved asset protection:* Trust-friendly states generally offer greater protection of your assets and bequests from potential creditors, particularly former spouses and other relatives through marriage. Such states have stronger laws regarding who can file suits and under what terms. Practically speaking, the new lawyers may require plaintiffs to pay a legal retainer to file a suit in their state. California permits lawyers to sue without a retainer, since the trust itself may have to pay their fees, exposing your assets or insurance proceeds to potential legal expenses even if you are not at fault. Although Limited Liability Companies (LLCs) can offer some protection, California has no asset protection legislation for individuals.

5) *Reduced state taxes:* If you have a California trust or trustee (even for a trust in another state) the California Franchise Tax Board will tax your trust in some way. The state will also tax any California heirs' or beneficiaries' trust income, no matter where the trust is located. If your beneficiaries don't need the money and you want your estate assets to grow free of California income tax, consider locating the trust elsewhere or moving an irrevocable trust to a trustee in another state. (You may also change some terms of an irrevocable trust via decanting after moving it to the new state; in decanting, the assets of a trust are paid into a new trust with new provisions.) While federal taxes always apply, you can take steps to minimize future state taxes.

6) *Longer trust terms:* Some states have longer limits on the term of a trust – the time when a trust must be terminated and the assets distributed to the beneficiaries. In California, that limit is to about 90 years. In some states, the limit can extend to 300 or even 1,000 years. This can assist families who want to preserve their wealth for future generations by designing trusts with incentives that encourage heirs to enhance their educations, ensure that all of their medical costs are covered, and even can be designed to protect heirs from creditors and to take such steps to become better members of society.

Sound estate planning always aims to meet your and your family's goals and needs. This is usually best accomplished through mission-based planning, which involves your spouse, family members, and, potentially, other heirs and beneficiaries. Mission-based estate planning encourages discussion of goals and needs and can help you secure beneficiaries' buy-in regarding your estate plan. *You retain control* but can work to minimize the likelihood of costly conflict after you're gone.

However you go about planning, consider beneficiaries' states of residence and bear in mind that laws are changing rapidly in this area as states vie for trust business, on the one hand, and, on the other, seek increased revenue. Also understand that relocation of a trust, together with decanting, can sometimes be used to change the distribution or terms of distribution of a beneficiary, subject to the new state's laws. (Many financial institutions have departments in various states to assist clients in locating their trusts.)

One final note: Procrastination creates disappointment. When they were wed 37 years ago, a couple started out with good jobs but no assets. Over the years, they acquired significant real estate, which they held in their personal names. They had three grown children and were in their early 60s when they started transferring their properties to various types of entities and trusts that would have helped protect the assets from taxation upon either of their deaths. They had only a few steps remaining to complete this process when, without warning, the wife died in her sleep. While her husband and children were spared much of the financial pain they could have suffered, he had to pay about $1 million in estate taxes because the original documents, as drafted, still applied. He called that $1 million "the price I paid for delaying what I wanted to do."

We all have good intentions for our heirs and beneficiaries, but until they are expressed in legally enforceable documents they remain only intentions. Procrastination can cost you, your loved ones, and your descendants dearly. Take steps now to place your assets in a properly designed trust in a state where your privacy will be respected, your assets protected, and your intentions honored, to the long-term benefit of the people you love. •MJ