NAILING THE BAR ™

Simple
CALIFORNIA
WILLS & TRUSTS
Outline

Tim Tyler, Ph.D., Attorney at Law

NINETY PERCENT of the LAW in NINETY PAGES®

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[With Explanation of Tax and Medi-Cal Considerations and Special Needs Trusts]

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This outline gives a simple explanation of the **BLACK LETTER LAW** and **BRIGHT LINE RULES** of **CALIFORNIA WILL and TRUST** law as set forth in the California Probate Code and tested on the California General Bar Exam. In addition it explains a lot of things you need to adequately practice probate law and estate planning in California.

While some provisions of the California Probate Code are the same as the probate provisions in other States some are very unique. And since these unique provisions are heavily tested on the California Bar Exam, **you need this outline specific to California law to adequately understand this subject.**

California Probate Law is explained here in **plain English** with **examples**.

This book discusses some **case law**, but case discussion is avoided when possible because it is often more confusing that illuminating.

YOUR PROFESSOR may focus on the details of the law in one or more narrow areas of personal interest. Those details are not covered here. **As you realize a need for more detailed knowledge** in a particular and narrow area of law, consult an appropriate **hornbook from your library** or some other authoritative reference source.

OTHERWISE, THIS BOOK HAS ALL THAT YOU NEED to really understand **California Probate Law** (Wills and Trusts) for law school and California Bar examinations, and you will find the explanations given here to be far more understandable than you can get from any other source.

Further, this book also includes explanation of estate and tax planning issues that are not tested on Bar Exams at all, but are often far more important than issues that are tested.

UNDERSTANDING THE LAW IS NECESSARY BUT NOT ENOUGH to succeed in law school! You must also be able to **explain** how the law applies to fact patterns presented on examinations.

THEREFORE, after you have developed an understanding of the law using this book, you MUST make additional efforts to prepare for your law school exams. To do that, use Nailing the Bar's **How to Write Essays for Wills and Trusts Law School and Bar Exams (HIe)**.

Details on that publication and how to obtain it are given at the back of this book.

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Chapter 1: Estate Planning Overview

Wills and Trusts are simply two "instruments" used in the general area of law called "**probate law**". [1] They are used to convey property from "donors" to or for the benefit of "**beneficiaries**". Conveyances of property by both Wills and Trusts are said to be "**by devise**". This process of conveying property from donors to beneficiaries is the essence of "**estate planning**".

It is often said that, "The rich get richer and the poor get poorer". That is true, and the reason, more than anything else, is **ESTATE PLANNING**.

The **California Bar** frequently tests certain issues concerning Wills and Trusts that are of little or no practical importance and totally fails to test estate planning issues of vital importance.

Law schools add to this confusion by having students read cases concerning Will and Trust rules outside California. That is simply a confusing waste of time because if you want to pass the California Bar Exam and practice as an attorney in California you need to understand California rules, not contradictory rules of law in other States.

This book explains everything you need to know to succeed in a California law school class on Wills and Trusts and pass the California Bar Exam. In addition, it explains how to protect yourself and your clients from unnecessary probate expenses and taxes.

As you read this book you are likely to think, "This isn't explaining anything the professor has been saying." But if you simply proceed through this book you should find a lot of the confusion you have been suffering will quickly disappear, you will understand what the professor is saying, and you will learn what attorneys should know but are not taught in law school.

1. Basic Will Concepts

Wills only take effect at the death of the decedent who is called a "**testator**". Individuals who die with Wills are said to have "**died testate**" (as opposed to "**intestate**").

A Will usually nominates a person to be an "**executor**" (or "**executrix**" in the feminine) who is responsible for paying the testator's debts and distributing the remaining assets in the deceased testator's "**probate estate**" to or for the benefit of the **beneficiaries** of the Will.

Wills are always **revocable** by the testator unless the testator has entered into a binding contract, supported by consideration, stating the Will cannot be revoked. That is called a **Will contract** and usually arises when two testators create a "**joint Will**". Will contracts are rare.

[1] For purposes of clarity the words "will" and "trust" will be capitalized when used to refer to probate documents (nouns) and not capitalized when used as verbs or prepositions. I trust you will appreciate the wisdom of this?

2. Basic Trust Concepts

A who creates a Trust is called either a "**settlor**" or "**grantor**". The term "settlor" is generally used by academics and the term "grantor" is generally used by probate lawyers.

An essential requirement of all Trusts is that grantors must convey assets into them, and those assets are called the "**Trust estate**".

All Trusts must also have a **trustee** who is responsible for managing, using or distributing the Trust estate to benefit the **beneficiaries** of the Trust as intended by the grantor.

3. Basic Estate Planning

Wills and Trusts are estate planning instruments. Long ago Wills were about the only "estate planning" instruments used. Trusts were only created by Courts when estates were left to minor children.

Modernly the costs of the "probate process" and the **Estate Tax** provisions of the U.S. Tax Code have caused a huge increase in the popularity of **living Trusts** and they have become the main vehicle for estate planning along with "**pour-over Wills**" as an ancillary instrument. A "pour-over Will" is one that simply conveys to a Trust all property of a deceased grantor that was not already part of the Trust estate at the grantor's death.

Other estate planning instruments often created as part of an "**estate plan**" are "**Durable Powers of Attorney**" and "**Advanced Health Care Directives**" (AHCD).

4. The Varying Meaning of "Estate"

"**Estate planning**" means creating strategies to convey individuals' estates to beneficiaries with minimum expense and tax liability. The term "**estate**" has different meanings.

In California a "probate estate" is the **separate property** owned by a decedent at the time of death and, if they are married, <u>half</u> of the **community property** and **quasi-community property** owned with a spouse. California does not recognize **dower** or **curtsey rights** and that is **never tested** as a "Will" or "Trust" issue. If it is tested at all, it would be on an MBE real property question.

A "**Trust estate**" is the assets conveyed to a Trust. If individuals convey assets to Trusts during life they are no longer part of the individual's probate estate.

A "**taxable estate**" is defined by the U.S. Tax Code for purposes of federal Estate Tax.

In addition to these concepts the "**estate subject to Medi-Cal recovery**" after an individual dies is also a consideration.

Good estate planning usually entails <u>minimizing the "probate estate", "taxable estate" and "estate subject to Medi-Cal recovery</u>" because the larger those values are the less the beneficiaries will receive.

5. The Probate Estate

Under California law the term "**probate estate**" means the gross market value of the property of decedents (valued at the date of death without recognition of the decedent's debts) inside California which is held in the decedents' names after their death that must be distributed pursuant to the provisions of the California Probate Code, as set forth in Wills or else through the process of **intestate succession** if decedents die intestate.

Assets that pass directly from decedents to beneficiaries otherwise are said to have passed "**outside of probate**". One goal of estate planning is to maximize the amount of assets that pass outside of probate to reduce the size of the probate estate.

Assets that pass from decedents to beneficiaries "outside of probate" are:

- Gifts during life including assets conveyed to trusts;
- Personal property held in joint title with other people (e.g. joint bank accounts, joint stock accounts);
- Real property held in joint tenancy or community property with right of survivorship;
- Financial accounts with a named beneficiaries (e.g. bank accounts); and
- Life insurance policies (including annuities) with named beneficiaries.

These non-probate transfers are defined and controlled by Division 5 of the California Probate Code (CPC §§ 5000-5705). It can be accessed at www.leginfo.ca.gov/calaw.html.

Assets that do not pass outside of probate become the "probate estate". The "**probate process**" is the process of passing the probate estate to the beneficiaries.

> **For example:** Huey owns Blackacre in California which is worth $5 million, but he has mortgaged it for $1 million. If he gives Blackacre to his son Louie before his death as a gift or else passes it to him at his death via a living Trust it will pass "outside of probate" and his probate estate will be $0. But if he passes it to Louie via a Will it will have to go through the probate process and his probate estate will be the gross value of $5 million even though it is subject to a mortgage.

6. The Taxable Estate

Under the U.S. Tax Code the term "**taxable estate**" means the net market value of all assets, everywhere, owned by a decedent at the date of death, PLUS all the net market value of all assets conveyed to Trusts, whether revocable or not, PLUS the net value of all assets given away before death LESS assets transferred to a surviving spouse, and LESS gifts given during life that are less than an annual statutory allowance (which is currently $13,000 per donee).

The taxable estate is effectively equivalent to all of the assets in the probate estate PLUS all of the assets that pass "outside of probate" as explained above, LESS the debts of the decedent, and LESS all assets that transfer to a surviving spouse. The assets that pass to the surviving spouse are called the "**marital deduction**".

Gifts that are less than a statutory annual amount to each donee (currently $13,000 per donee) are also not counted as part of the taxable estate.

Once the taxable estate is determined, gross estate tax is calculated based on graduated tax rates. From that amount a "**unified credit**" is deducted that effectively makes a flat amount of the taxable estate "un-taxed". For 2009 that amount was $3.5 million and that is widely expected to be the un-taxed amount in 2010 and future years.

For 2009 the federal estate tax rate is effectively 45% and that is widely expected to be the tax rate in 2010 and future years.

There is no "California Estate Tax". Rather, after the federal government collects estate taxes from California residents it rebates a portion of the taxes collected to the State.

> **For example:** Huey owns Blackacre in California which is worth $5 million, but he has mortgaged it for $1 million. Whether he passes Blackacre to his son Louie as a gift during life, at his death via a living Trust, or passes it to Louie through the probate process, Huey still has a net probate estate of $4 million ($5 million less the debt of $1 million). If the property passes at Huey's death the **unified credit** effectively reduces his **taxable estate** to $1.5 million and the estate would be liable for $675,000 in federal estate taxes (under 2009 rules).

Part of an "estate planning" strategy may be establishment of a "gifting plan" to reduce the size of the taxable estate at the death of the client. Each gift in each year to each recipient must be no more than the "statutory amount" which is currently $13,000.

> **For example:** Huey has $4.8 million and gives $13,000 each year to each of his 25 children, grandchildren, nieces and nephews. He is distributing $325,000 each year and that does not get counted as part of his taxable estate. After 4 years he will have given away $1.3 million, and his taxable estate will have been reduced to $3.5 million, the amount of the unified credit (under 2009 rules). As a result his estate has been made non-taxable! [2]

Note that the "unified credit" and annual gift limit for federal estate taxes has frequently changed, and it is not even certain what those amounts will be for 2010 and following years, even though this is being written in 2010. It is widely expected that Congress will pass legislation sometime in 2010 that will reset these limits retroactively to January 1, 2010.

Further, the "unified credit" for Gift Tax purposes (as opposed to estate taxes) is less and only shelters $1 million (under 2009 rules). That is **never tested** and will not be explained here in any further detail.

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[2] If any of the beneficiaries are minors the $13,000 gifts to them can be made subject to the California Uniform Transfers to Minors Act (CPC § 3900 et seq.) and held by an adult appointed to act as "custodian" over the money.

7. Estates Subject to Medi-Cal Recovery

Middle class and blue collar workers are often more concerned about avoiding Probate Court and Medi-Cal recovery than Estate Taxes.

Medicare is the federal healthcare program for people over 65, and it is of no concern in estate planning

Medicaid is a healthcare program for the poor, regardless of age, that is partially funded by the federal government and partially funded by the States, and most importantly <u>it will pay for nursing home care</u> if patients qualify. The federal government has established guidelines for how States should run these programs, but within those guidelines States have some leeway.

Medi-Cal is what California calls its implementation of the federal Medicaid program.

Medi-Cal has the right to recover the costs of health care it pays from the estates of deceased recipients. Medi-Cal also has the right to recover its expenditures from the remaining Trust estate of **Special Needs Trusts** at the deaths of their beneficiaries <u>if the Special Needs Trust was funded with assets that belonged to the beneficiary</u> (i.e. “self-funded Special Needs Trusts).

Except for the case of self-funded Special Needs Trusts, Medi-Cal has only pursued “recovery” in past years by filing liens against the <u>residences</u> of the deceased Medi-Cal recipients. And at times Medi-Cal only sought to recover the cost of nursing home care in these cases.

At the present time Medi-Cal does not file a lien against the home of a deceased recipient if there is a surviving spouse, minor child, or totally disabled child of the recipient residing in the home. However, Medi-Cal can recover its costs from the estate of a surviving spouse of a deceased recipient when the surviving spouse dies, even if the surviving spouse did not receive Medi-Cal assistance.

For a number of years insurance companies targeted elderly people in California with schemes to sell them insurance and annuity policies claiming that they could use all of their non-exempt assets (i.e. life savings) to buy those policies (payable upon their death to their children or other beneficiaries) and thereby “spend down” to immediately become eligible for Medi-Cal. Many of these schemes were financially abusive to the elderly. In response Medi-Cal changed its rules some years ago to require applicants seeking eligibility to give Medi-Cal the right to seek recovery against insurance and annuity policies of this type.

Medi-Cal rules are very complicated and change frequently. However, the asset of a deceased Medi-Cal recipient that is most often targeted for recovery is the recipient’s personal residence and their interests in certain insurance and annuity policies.

Chapter 2: Durable Powers of Attorney

The use of **power of attorney** forms is seldom explained in law school and **never tested**. But many people execute them as part of an estate plan. <u>This is seldom a wise idea.</u>

A "power of attorney" is a legal form executed by a natural person with contractual capacity, the **principal**, that entrusts another person, the "**attorney-in-fact**" with legal authority to act as the principal's **agent**. (CPC §§ 4000 et seq.) Powers of attorney can be granted with broad or limited powers.

If the attorney-in-fact is authorized to act on behalf of the principal even if the principal becomes incapacitated, it is called a **Durable** Power of Attorney. If the Power of Attorney form does not say it is "durable" it has no legal value if the principal becomes incapacitated.

A "**springing**" Power of Attorney is one that becomes effective only at a specific future date or in the event a condition fails or occurs.

A Power of Attorney form does NOT give the attorney-in-fact the legal power to do the following <u>unless it expressly states these powers are being granted:</u>

- To create, modify or revoke a Trust;
- To make gifts of the principal's property; or
- To make loans of the principal's property to the attorney-in-fact.

Attorneys-in-fact generally **have no duty to act or continue to act** on behalf of principals, even if they have become incapacitated. (CPC § 4230.)

Attorneys-in-fact have **no greater duty than any other person** to use and manage the principal's property and are not bound by the investment duties of fiduciaries. (CPC § 4231.)

Attorneys-in-fact can **take or use assets of the principal** and the <u>burden is on the principal</u> to prove it was wrongful. In contrast if a trustee **takes or uses assets of a Trust** the <u>burden in on the trustee</u> to prove it was proper.

<u>Third parties who rely in good faith</u> on a properly executed power of attorney form have no liability to the principal. Consequently, once power of attorney is granted, the principal usually has no legal recourse against anyone except the attorney-in-fact.

Revoking a power of attorney requires **actual notice** to the attorney-in-fact, and third parties who do not get **actual notice** have no liability to the principal if they act in good faith reliance on a power of attorney form presented to them, even if they do so negligently.

Chapter 3: Advanced Health Care Directives

Like powers of attorney, Advanced Health Care Directives (AHCDs) are seldom explained in law school and **never tested**. But most people execute them as part of an estate plan, and often they are of <u>intense interest to some clients</u>.

In the past AHCDs were often called "**living wills**" or "**Powers of Attorney for Health Care Decisions**" and may still be referred to in that manner. But in 2000 the California Legislature directed that they be called AHCDs. (CPC §§ 4670 et seq.)

An AHCD is simply a form on which individuals appoint other people to be their "agents for health care decisions" after they are unable to make those decisions for themselves, and state their preferences concerning being kept on life support after highly educated medical experts have determined based on extensive testing they are suffering from an incurable fatal disease. These are <u>critical for clients diagnosed with Alzheimer's Syndrome</u> or other forms of degenerative dementia.

The client who really <u>needs</u> an AHCD is a young man in his 20s called "Gorp" who drives fast on a motorcycle. But Gorp couldn't care less because he is a real risk taker. His motto is, "Life is to be lived by golly!" But when Gorp falls off and scrambles his brain he is going to be strung up to life support machines urinating into a bag for the next 30 years because his heart, lungs, kidneys and other vital organs are in great shape. Have a nice life, Gorp.

The client who is <u>intensely eager</u> to get an AHCD is a lady in her 80s called "Matilda" who has diabetes, failed kidneys, cancer and congestive heart failure. She thinks about death a lot and is scared to death she is going to be kept on life support. But realistically, if Matilda ever needs life support at all, it won't be for long because all her other health problems will cut her stay in the ICU very, very short.

An AHCD should not be confused with a "Do Not Resuscitate" form (DNR)! A DNR tells ambulance drivers, cops, EMTs and other emergency workers, who are often high-school dropouts with little medical training, to NOT PERORM life-saving acts on stricken individuals who otherwise might be saved, regardless of what is wrong with them.

Ask yourself, do you want the decision whether you should live or die made by a high-school dropout who doesn't know much more than how to drive an ambulance?

> **For example:** Fred who is in very good health chokes in a restaurant on a piece of steak. EMT Gomer starts CPR but Ethyl stops him saying, "He has a DNR." So Gomer lets Fred die. Then Ethyl remembers Fred didn't have a DNR, he had an AHCD. Ethyl is real sorry, Fred.

Chapter 4: Probate Basics

An understanding of the basic probate process and basic rules, terms and concepts is necessary to understand the principals of Wills and Trusts. Much of this is never tested on exams but if you don't understand it you will have difficulty understanding that things that are tested.

1. The Probate Process

The "probate process" is a general term for how the California Probate Code governs distribution of the **probate estate** of a decedent and who will supervise that distribution.

The probate estate may be distributed with Court administration (under the supervision of a probate court judge) or without Court administration in some cases. Even if the estate is to be distributed "without administration" Court oversight still may be involved to some extent.

2. No Probate if Decedent Lacks a Probate Estate

It goes without saying that if decedents die without leaving a probate estate to be distributed, there is no "probate process" because there are no assets to distribute through probate. That is one of the major benefits from using a **living Trust** and other estate planning strategies. If the probate estate can be reduced to zero the probate process can be avoided. Otherwise the decedent's probate estate will have to be distributed through the probate process.

3. Court Jurisdiction and Venue

California Superior Courts have **general jurisdiction** over the administration of decedent's estates if they were domiciled in California or died owning real property in California. (CPC § 7050.) This is true whether the decedent died **testate**, **intestate**, or with a living Trust.

If the decedent was domiciled in California at the time of death, the **proper venue** for filing estate probate actions and administering the decedent's estate is the **county of domicile**, regardless of where the decedent died. (CPC § 7051.)

The proper venue for commencing Trust actions (e.g. challenging the acts of a trustee) is the County where the trustee is located for a living trust, the County where the estate is administered for a testamentary trust, and otherwise any County where property of the Trust is located.

If the decedent was not domiciled in California but died in California, venue is proper in the County **where the decedent died** if property located in that County belongs to the decedent's probate estate. (CPC § 7052.)

Otherwise, if the decedent was not domiciled in California and did not die in a California County where in the decedent's probate estate is located, venue is proper in any County **where property in the probate estate is located**. (CPC § 7052.)

A California Probate Court only has authority over real property within California. To probate the distribution of real property of the decedent in another State a probate action must be instituted in that other State where the real property is located, and usually in the County where it is located. A probate action in another State is called an "**ancillary action**" because it is generally ancillary to (in addition to) another probate action filed in the California courts.

4. Generally no Jury Trials

There is no right to a jury trial in Probate Court except when the Probate Code expressly grants that right, and the vast majority of probate actions are conducted before and determined by the judge without a jury. However it is possible to demand a jury trial as to questions of fact. But it is unusual.

5. Sworn Pleadings and Relaxed Rules of Evidence

In California Probate Courts all court filings alleging facts (petitions, objections, motions, oppositions, etc.) must be sworn to be true and signed under penalty of perjury by the moving parties. The Court (judge) may admit all such statements into evidence unless they are disputed by opposing parties. This effectively means that all hearsay is admissible evidence unless it is objected to by opposing parties.

Chapter 5: General Estate Distribution Rules

The shares of estates distributed to beneficiaries by provisions in Wills or Trusts are often called "testamentary gifts". The portions of probate estates distributed by the rules of intestate succession are generally referred to as "shares". Some general estate distribution rules apply to the distribution of all estates, whether they are distributed pursuant to the provisions of Wills, Trusts or other "donative" documents. These rules are often taught within the context of "Wills" but they apply to the distribution of all estates.

1. Issue, Children and Relationships

Probates estates and Trusts often concern "issue", "children", "kin" and other relatives of the decedent and particular rules of law apply to define those relationships.

The "**issue**" of a person is the person's lineal descendents of all generations with the relationship of "**parent and child**" existing at each generation. (CPC § 50.)

A "**child**" of a person is entitled to take a share of an estate under the rules of intestate succession. (CPC §26.) Illegitimate ("**non-marital**") children are treated the same as all other children.

The "**kin**" of a person are those who are related by blood (not marriage).

Relatives of a decedent that are **conceived before the decedent dies** but born afterward are treated as if they were born before the decedent died. (CPC § 6407.)

Under the rules of intestate succession relatives of the **half-blood** generally inherit the same as relatives of the whole blood. (CPC § 6406.) Further, a relationship of "**parent and child**" exists between children and their natural parents, regardless of the parent's marital relationship, and between legally adopted children and their adoptive parents. (CPC § 6450, et seq.)

> **For example:** Art and Betty have two natural-born children, Carl and Diane. But Art has an affair with Ethel and fathers another child Frank out of wedlock. Then Art and Betty legally adopt an unrelated child Gretta. If Art dies intestate all of the children, Carl, Diane, Frank and Gretta will be treated as if they were his natural-born children. If Betty dies intestate only Carl, Diane and Gretta will be treated as her natural-born children. And if any of the children (Carl, Diane, Frank or Gretta) die intestate, the survivors of the four will be treated the same as their natural-born siblings.

Also, a "**parent and child relationship**" may exist between step-children and step-parents, and between foster children and foster parents in certain circumstances. (CPC § 6454)

But a **legal adoption** severs the "parent and child" relationship between children and their natural parents except in certain defined circumstances. (CPC § 6451.)

> **For example:** Art and Betty have two natural-born children, Carl and Diane. Then Art has an affair with Ethel and fathers another child Frank out of wedlock. Ethel later marries Moe and he legally adopts Frank. If Art, Betty, Carl or Diane die intestate, Frank will not

be treated as if he were related to any of them because his relationship to them through his natural father Art was severed when he was adopted by his adoptive father Moe.

A person who is related to a decedent through **two blood lines** can only receive a single intestate share and will receive the larger intestate share of the two lines. (CPC § 6413)

No person is prevented from inheriting an intestate share because they or some person through whom they have a right to a share is an **alien**. [3] (CPC § 6411.)

Although these terms are based on the rules of intestate succession, the same terms and definitions apply to interpretation of Wills, Trusts and other "donative" documents.

2. Definition of Predeceased and Survival

Probate estates are only distributed only to heirs at law and testamentary beneficiaries that have "survived" the decedent, and survival to some stated age or for some period of time is often an express requirement of Wills and Trusts. An "**heir at law**" is a person who would inherit an intestate share of a decedent's estate, and a "**testamentary beneficiary**" is a person who would receive a testamentary gift from a decedent under the terms of a Will or Trust.

Under California law a person does not "survive" a decedent, for purposes of receiving an <u>intestate</u> share of the decedent's estate, if the heir or beneficiary does not live for 120 hours or more after the decedent dies. (CPC § 6403). This same rule applies to <u>testate</u> distribution unless the terms of a Will or Trust provide for a different rule.

> **For example:** Everything Hal and his wife Wanda own is community property. Hal has a child, Junior, from a previous marriage, but Wanda has no children. They are in a bad auto accident and Hal dies intestate at the scene. Wanda is taken to a hospital where she later dies testate with a Will that says all her property goes to a charity. If Wanda lived for 120 hours or more after Hal died, she "survived" him and inherited his half of the community property. In that case everything Hal and Wanda owned goes to the charity. If Wanda did not live for 120 hours or more after Hal died she did not inherit his half of the community property and only her half of the community property goes to the charity. Hal's half of the community property would go to Junior.

3. Distribution of Class Gifts

A **class gift** is a gift of a <u>single amount</u> to be <u>shared</u> equally by a group of donees, <u>uncertain in number</u>, so the share of each member is unknown with certainty until the class "closes." A person is a **class member** if they 1) **meet class requirements** 2) **while the class is open**. This is occasionally tested in **Real Property, Wills** and **Trusts** scenarios.

> **For example:** Donald executes a Will that says, "I give $6,000 to my grandchildren." That is a class gift because it gives a single amount ($6,000) to a group of people, "Donald's grandchildren". It is uncertain in number because there is no way to predict how many grandchildren there will be to receive the gift at Donald's death.

[3] This means "not a U.S. citizen", not from outer space.

Under the "**Rule of Convenience**", if a class has any members when the gift to it becomes irrevocable, it is "not an empty class". Then it **closes when any of its members qualify to take possession in beneficial enjoyment** of their shares.

> **For example:** Donald executes a Will that says, "I give $6,000 to my grandchildren if they reach the age of 21." When Donald dies he has one grandchild. The class is not empty, so it remains open until any one grandchild reaches the age of 21. Then that grandchild can "take possession in beneficial enjoyment" and the class will close. That means any grandchildren born before that get a share and those born after that get nothing.

But if a class has NO members when the gift to it becomes irrevocable, it is "a gift to an empty class". Then it **closes when it becomes impossible for new members to come into existence**.

> **For example:** Donald executes a Will that says, "I give $6,000 to my grandchildren if they reach the age of 21." When Donald dies he has NO grandchild. The gift becomes irrevocable and the class remains open until it is impossible for any more "grandchildren" of Donald to be born. That means all grandchildren of Donald get a share, but none of them get anything at all until **ALL children of Donald have died**.

Gifts to an "empty class" lapse, and class gifts by Will or Trust that violate the **California Rule Against Perpetuities** also fail. (CPC § 690.) That will be explained later.

4. Distribution of Specific Gifts

Under California law a "**specific gift**" is a gift of specifically identifiable property. (CPC § 21117.)

> **For example:** Donald executes a Will that says, "I give my Ford Mustang to Huey." That is a specific gift because it gives a specific, tangible thing to Huey.

Specific gifts are usually to individuals but they can be to a class.

5. Distribution of General Gifts

A "**general gift**" is a transfer from the general assets of the transferor that does not give specific property. (CPC § 21117.)

> **For example:** Tess executes a Will that gives $5,000 to her friend Betty. That is a general gift.

6. Distribution of Demonstrative Gifts

A "**demonstrative gift**" is a general gift that identifies the fund or property from which the gift is primarily to be made. (CPC § 21117.)

For example: Tess executes a Will that says, "I give $5,000 to Betty from my savings account at Monopoly Bank and Trust." That is a demonstrative gift because it states where and/or how the money to be given is to be obtained.

7. Distribution of Annuities

An "**annuity**" is a general pecuniary gift that is to be paid periodically. (CPC § 21117.)

For example: Tess executes a Will that says, "Betty is to receive $1,000 from my estate every month for 60 consecutive months." That is an annuity.

8. Distribution of Residuary Gifts

A "**residuary gift**" is a gift of property that remains after all specific and general gifts have been made. (CPC § 21117.)

For example: Tess executes a Will that says, "I give $5,000 to Betty and the rest of my estate to Rosario." The gift to Rosario is a residuary gift because it gives her everything left over after Betty gets the $5,000.

9. Intestate Distribution

If there are assets remaining in an estate (probate or Trust estate) after all specific and general gifts have been distributed, but no residuary gift is provided for, they must be distributed by intestate distribution.

The rules of intestate distribution are explained in detail in a following chapter.

10. Lapse for Failure of Condition

Testamentary gifts may lapse due to the **failure of express or implied conditions**. To "lapse" means the gift fails. Any specific property that was to be given to the named beneficiary is distributed to other beneficiaries by default.

For example: Tess executes a Will that gives $5,000 to Sue if she has graduated from college. If Betty has not graduated by the time Tess dies the gift to her will lapse. In that case it will be distributed to other beneficiaries named in Tess' Will or else will be distributed to Tess' intestate heirs.

An <u>implied condition</u> of testamentary gifts is that the beneficiaries must survive until their interests become vested. If beneficiaries die **before the testamentary instrument is executed** OR **before the gifts become vested** that condition fails and the gifts **lapse** UNLESS the gift is saved by the **California anti-lapse statute**. Lapse is **most often tested** in this context.

Beneficiaries of Wills generally must survive the testators and beneficiaries of revocable Trusts generally must survive the grantors because that is when their interests become vested.

Even if beneficiaries live to take possession of testamentary gifts in beneficial enjoyment, they will be treated is if they died before their interests became vested if they "disclaim" their interests. That is explained in the following section. In that case their interests will be distributed as explained here.

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A. Provisions for Alternative Beneficiaries

A testamentary gift does not lapse if an alternative beneficiary is provided for in the testamentary instrument who has a right to receive the gift.

> **For example:** Tess executes a Will that says, "I give $5,000 to Betty, but if Betty does not survive me the gift is to go to Sue." If Betty dies before Tess but Sue does not, the gift will not lapse and will go to Sue. But if both Betty and Sue die before Tess the gift will lapse.

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B. Effect of Lapse of Shares in Class Gifts

If a beneficiary's share of a **class gift** lapses, that share is redistributed to all the other surviving members of the class in proportion to their other interests in the class gift, and the gift to the class, as a whole, does not lapse. (CPC § 21111 (b).)

> **For example:** Donald executes a Will that says, "I give all of my estate to Huey, Louie and Dewey with half of it to Huey and Louie and Dewey each getting a fourth." That is a class gift because it gives a single amount ("all of my estate") to a group of people. If Louie dies before Donald, and the anti-lapse statute does not apply, his share lapses and will be redistributed to the surviving members of the class, Huey and Dewey. Since Huey was to get twice as much as Dewey, he would get 2/3 of the estate and Dewey would get 1/3.

But if <u>every beneficiary's share</u> of a **class gift** lapses the class is "empty" and the entire gift to the class lapses.

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B. California Anti-Lapse Statute

Under the **California anti-lapse statute** (CPC § 21110) testamentary gifts to beneficiaries who die before the testamentary instrument is executed, or who fail or are treated as having failed to survive the donor (testator or grantor) will generally not lapse if they were "kindred" of the donor (transferor) or of the transferor's surviving, deceased or former spouse. (CPC § 240.). Rather the gifts will be distributed to the **issue of the beneficiaries, per stirpes** unless the instrument indicates a contrary intention.

The term "kindred" means people related by blood or legal adoption.

If the beneficiaries are not survived by issue the gifts lapse anyway.

> **For example:** Donald executes a Will that says, "I give the sum of $6,000 to be divided equally between my <u>nephews</u>, Huey, Louie and Dewey." Huey dies before Donald does, and he is survived by a single child, Sonny. Huey's share will not lapse because he is a "nephew" of Donald and that makes him "blood kin". His share will go to Sonny, his only <u>issue</u>, and not to Louie and Dewey.

This rule applies to class gifts, but does not apply to members of the class that die before the testamentary instrument (Will / Trust) is executed, <u>if that fact was known to the donor</u>.

> **For example:** Donald executes a Will that says, "I give the sum of $6,000 to be divided equally between my <u>nephews</u>." Donald had three nephews, Huey, Louie and Dewey. But since the Will only says "nephews" and does not name them, this is a <u>class gift</u>. If Huey had already died before Donald executed his Will, <u>and Donald knew that</u> when he executed the Will, Huey's son, Sonny, gets nothing.

It is important to understand the California anti-lapse statute does NOT reserve the shares of deceased beneficiaries for either their <u>beneficiaries</u> (under their Wills) or for their <u>heirs</u> (by intestate succession). Rather, it reserves the shares of predeceased beneficiaries (who must be kin of the testators or grantors) for their <u>issue</u> (descendents) only. And if the deceased beneficiary has no issue, the gift will lapse anyway.

> **For example:** Donald executes a Will that says, "I give the sum of $6,000 to be divided equally between my <u>nephews</u>, Huey, Louie and Dewey." Huey dies before Donald survived only by his wife, Helga. Helga is Huey's "heir" and she may also be the "beneficiary" of his Will. But she is not going to get Huey's share of the $6,000 because she is not Huey's "issue". Even though Huey is Donald's "blood kin" his share will lapse and go equally to Louie and Dewey because he died before Donald, and without issue.

11. Disclaimer

People who have vested interests or rights to receive intestate shares of estates or testamentary gifts under the terms of Wills or Trusts can reject or "**disclaim**" their interests. (CPC §§ 260 et seq.) To do so the person disclaiming an interest must state their disclaimer in a written statement delivered to the appropriate recipients within a reasonable period of time after becoming aware of their interest. The requirements for that are set forth in statute.

The effect of a disclaimer is that for most purposes <u>the disclaimed interests will be distributed or otherwise treated as if the disclaiming parties died before the events that gave them the disclaimed interests</u> unless there is a provision in the Will, Trust or other instrument that created their interests that specifically directs some alternative disposition of the interest in the event of a disclaimer. (CPC § 282.) In that case their interests would be distributed as if they had died as explained in the preceding section on lapse for failure of condition.

By law, a disclaimer is NOT a fraudulent transfer that can be reversed by a Court.

> **For example:** Pops dies intestate and his only child, Hannibal is in prison for life (he ate someone's liver with Fava beans and a nice, light Chianti). Hannibal stands to inherit several million dollars. But if Hannibal receives that interest it will be seized by the

> Department of Corrections to pay its expenses for keeping him in prison for the rest of his life. So if Hannibal disclaims his interest in Pop's estate it will be distributed as if he died before Pops. If Hannibal has an only child, Sonny, the effect of the disclaimer would be that Pops' estate will descend to Sonny pursuant to the terms of the California anti-lapse statute.

One thing a disclaimer will NOT do, according to the California Board of Equalization, is allow Sonny to receive real property without reassessment for property tax purposes. [4] That is explained in more detail later.

12. Lapse by Ademption

Generally **specific gifts** provided for beneficiaries in Wills or Trusts must be owned by the testators or grantors at the time the gifts are to take effect in possession or enjoyment. That generally means when the testators or grantors die. (CPC § 21133.) Otherwise the gifts are said to have "**failed by ademption**".

> **For example:** Donald executes a Will that says, "I give my Ford Mustang to Huey." That is a specific gift because it gives a specific, tangible thing to Huey. But the gift will "**fail by ademption**" if Donald gives the Ford Mustang to Louie before he dies.

"**Ademption by satisfaction**" means a specific gift fails because the property to be given to a beneficiary at the death of a testator or grantor was already given to the same beneficiary by the testator or grantor while they were alive. (CPC § 21135 (a) (4).)

> **For example:** Donald executes a Will that says, "I give my Ford Mustang to Huey." But Donald gives the Ford Mustang to Huey before he dies. The gift to Huey provided for in the Will fails because of "**ademption by satisfaction**".

"**Partial ademption**" means a specific gift fails in part because some of the property to be given to a beneficiary at the death of a testator or grantor no longer exists in the estate.

> **For example:** Donald executes a Will that says, "I give my 100 acre farm to Huey." But the highway department takes ten acres of the farm for a freeway right-of-way before Donald dies. The gift to Huey provided for in the Will partially fails because of "**partial ademption**".

While the general rule is that specific gifts fail by ademption if the property to be given is no longer in the estate at the death of a testator or grantor, California law provides some exceptions to that general rule:

- A gift of **securities** does not fail by ademption if the securities no longer exist because the corporation unilaterally **replaced them with different securities** or they were replaced with different securities because of a corporate **merger, consolidation, reorganization**, etc. (CPC § 21132.) In this case the beneficiary has a right to receive the securities issued in replacement;

[4] See their website at www.boe.ca.gov/proptaxes/faqs/propositions58.htm.

For example: Donald's Will was to give Huey Ameri-Air stock but it merged with Uni-Air and Donald was issued Air-Amer stock instead. At Donald's death Huey gets the Air-Amer stock.

- If property to be given to beneficiaries is sold by testators or grantors who **die before receiving all of the sales price** the sales proceeds received after their deaths belongs to the beneficiaries who were to be given the property. (CPC § 21132.);

  For example: Donald's Will was to give Huey Ameri-Air stock but he sold it just before he died. If the sale proceeds are not posted to Donald's brokerage account before he dies, at Donald's death Huey gets the sales proceeds.

- If property to be given to beneficiaries is destroyed but the testators or grantors **do not receive reimbursement from insurance** before they die the insurance proceeds received after their deaths belongs to the beneficiaries who were to be given the property. (CPC § 21132.);

  For example: Donald's Will was to give Huey his house but it burned down with Donald inside it. If hen Donald's casualty insurance company pays for the house after Donald's death, Huey gets the proceeds.

- If property to be given to beneficiaries is taken by a government agency by eminent domain but the testators or grantors **do not receive an eminent domain award for the property** before they die the government payments for the property received after their deaths belongs to the beneficiaries who were to be given the property. (CPC § 21132.);

  For example: Donald's Will was to give Huey his house but it was taken by the highway department by eminent domain. If the eminent domain award is not paid until after Donald dies, Huey gets it.

- If an **obligation** to be given to beneficiaries (e.g. note secured by a deed of trust) is not in the estate because it was replaced by other property because of **foreclosure** proceedings against the debtor or as a **payment to avoid foreclosure**, the property received in exchange belongs to the beneficiaries who were to have been given the obligation. (CPC § 21132.); and

  For example: Donald's Will was to give Huey a note and deed of trust he owned on a commercial building sold to Ninja Company. But Ninja failed to make its payments. Donald foreclosed on the property and Ninja deeded the building to him to satisfy its debt. Huey gets the building.

- A specific gift will not lapse by ademption if the **value of the gift can be traced to other property** in the estate (e.g. the property was sold but the sales proceeds have been held in a separate account) and **extrinsic evidence proves the testator or grantors did not intend for the gift to lapse** by ademption, then the beneficiary has a right to the property that resulted. This is **occasionally tested**.

  For example: Donald's Will gives Huey his Ford Mustang. But the car is stolen. When Donald receives reimbursement from his insurance company he puts the money aside and orally states, "This money is for Huey when I die because I promised him the car and it was stolen." Huey would receive the money in lieu of the car.

13. Per Stirpes Distribution

When an estate or a share of an estate is distributed **per stirpes** it is given to the living descendents of some person who has died (i.e. to the person's "issue"). Per stirpes distribution is also sometimes called "**by right of representation**". It is set forth in CPC § 240. That distribution is made as follows:

> The descendents of the deceased person are considered chronologically, generation by generation, until a generation is found with living members. Then the amount to be distributed is divided into as many equal shares as there are living members in that generation and deceased members with living descendents. One share is given to each living member and the shares of deceased members are divided among their living descendants in the same manner.

In trying to determine per stirpes distribution rights it helps to draw a simple "tree diagram".

> **For example:** Able's estate of $300,000 is distributed to his issue per stirpes. He is survived by one son, Bob. Bob has a son, Gary. Able's predeceased daughter, Carla, is survived by her sons Eric and Fred. Able had another son, Don, who died without issue. The oldest generation of "Able's issue" with living members is Bob's generation. There is one living member (Bob) and one deceased member of that generation with living issue (Carla). Able's estate is divided into two shares, $150k to Bob, and $150k to be distributed to Carla's issue, again, per stirpes, half ($75k) to Eric and half ($75k) to Fred.

The "tree diagram" for this example would look like this:

```
                         A
                     (decedent)
          _________________|_________________
B ($150k)          C (dead)              D(dead)
    |             _____|_________            .
    G        E ($75k)       F ($75k)           .
```

14. Lapse by Advancement

Advancements are inter vivos gifts by donors to donees that are deemed to be in satisfaction, in whole or in part, of at-death transfers from the probate or Trust estates of the donors.

> **For example:** Donald's Will provides that Huey is to be given $300,000 when he dies. If Donald gives Huey $100,000 while he is still alive, it may be deducted from the amount Huey was to receive at Donald's death, and Huey may only be given $200,000 when Donald dies. But this is only true <u>if that gift was deemed to be an advancement</u>.

Advancements can be in lieu of intestate shares in the probate estates of the donors. (CPC § 6409.) And advancements can be in lieu of testamentary gifts provided for in the donors' Wills or Trusts. (CPC § 21135.) In either case the rules are essentially the same EXCEPT there is **one important difference** between the two situations. That will be explained below.

Ademption by satisfaction was explained earlier, and that is a particular form of advancement that relates to **specific gifts** provided for in a testator's Will or in a grantor's Trust. But **general gifts**, (gifts of money), **demonstrative gifts**, **residual gifts**, and **gifts against intestate shares** can also be deemed to be advancements.

> **For example:** Huey is a potential intestate heir of Donald. If Donald gives Huey $100,000 while he is still alive, it may be deducted from the intestate share Huey would receive at Donald's death. But this is only true if that gift was deemed to be an advancement.

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A. General Rules for Advancements

Under CPC § 6409 and CPC § 21135 inter vivos gifts to donees (transferees) **will be treated as advancements** ONLY IF –

1. The Wills or Trusts involved (if any) **provide that lifetime gifts are to be deducted** from testamentary gifts (at-death transfers);
2. The donors (transferors) **declare in a contemporaneous writing** that the gift is to be deducted from at-death transfers (testamentary gifts or intestate shares); OR
3. The donees (transferees) **acknowledge at any time in writing** that the gift is to be deducted from at-death transfers (testamentary gifts or intestate shares).

> **For example:** Donald has three heirs at law, his nephews Huey, Louie and Dewey. Donald gives Huey $100,000 and states in writing at the same time the gift is to be deducted from any share of his estate that Huey might receive at Donald's death. That makes the gift an advancement. Donald dies intestate with an estate of $200,000. Louie and Dewey each get $100,000 and Huey gets nothing because he already got his $100,000 share from Donald before he died.

But it is important to remember advancements require a writing.

> **For example:** Donald's Will gives $300,000 to his nephew Huey but it does not have any provisions concerning advancements. Huey asks for an advancement of $100,000. Donald agrees and gives Huey the $100,000. Donald tells everyone the gift is an advancement and Huey admits that is true. But neither of them put it in writing. When Donald dies it will NOT be treated as an advancement because Donald's Will did not mention treatment of advancements and neither of them put anything in writing about it.

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B. The Difference between Intestate and Testate Advancements

The distinctive difference between advancements of intestate shares and advancements of testamentary gifts provided for in Wills and Trusts involves the distribution when donees (gift recipients, transferees) die before the donors (givers of the gift, transferors).

If recipients of gifts that otherwise would be treated as **advancements against intestate shares** <u>die before the intestate decedents</u> the gifts WILL NOT be deducted from the shares descending to the issue of the pre-deceased recipients unless a contemporaneous written declaration by the donor or a written acknowledgement by the donee provides otherwise. (CPC §6409 (d).) This only matters when the <u>recipients are survived by issue</u>.

> **For example:** Donald's three nephews, Huey, Louie and Dewey, are his heirs at law and Huey has a child, Duckie. Donald gives Huey $100,000 and declares in a written statement that the gift is an advancement against his estate. But his written statement <u>does not say Duckies' potential interest is to be reduced</u> by the advancement. Donald dies leaving an estate of $200,000. If Huey survives Donald, he gets nothing and Louie and Dewey each get $100,000. But if Huey dies before Donald, Duckie gets an equal share of the estate. Then Louie, Dewey and Duckie would each get $66,667.

In contrast to the intestate rule above THE RULE IS THE EXACT OPPOSITE in the case of testamentary gifts! If recipients of gifts that otherwise would be treated as **advancements against testamentary gifts provided for in Wills and Trusts** <u>die before the testators or grantors</u> the gifts WILL be deducted from the interests descending to the issue of the pre-deceased recipients unless a contemporaneous written declaration by the donor or a written acknowledgement by the donee provides otherwise. (CPC §21135 (d).) Here again, this only matters when the <u>recipients are survived by issue</u>.

> **For example:** Donald's Will provides that at his death his estate is to be divided equally between Huey, Louie and Dewey. Huey has a child, Duckie. Donald gives Huey $100,000 and declares in a written statement that the gift is an advancement against his estate. But neither Donald's Will nor his written statement <u>say how Duckies' potential interest is to be affected</u> by the advancement. Donald dies leaving an estate of $200,000. If Huey survives Donald, he gets nothing and Louie and Dewey each get $100,000. AND if Huey dies before Donald, Louie and Dewey still get $100,000 each and Duckie gets nothing.

15. Lapse by Abatement

An "**abatement**" is a partial or complete lapse or failure of a testamentary gift provided for in a Will or Trust because the estate (probate or Trust estate) lacks sufficient property to fund it. (CPC §§ 21400 et seq.) [5]

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[5] In this context the term "estate" means the property remaining after estate taxes and the debts, funeral expenses and expenses of last illness of the decedent have been paid and intestate shares have been distributed to omitted (pretermitted) spouses or children, if any. The rules for intestate distribution and pretermitted spouses and children are explained in later chapters.

For example: Donald's Will provides that at his death Huey is to be given $100,000. When Donald dies his probate estate only has $80,000 in assets. Huey will only receive $80,000 so there will be an "**abatement**" of $20,000.

If provisions are made in a testamentary instrument for abatement, those provisions control. Otherwise abatement is according to the provisions of CPC §§ 21400 et seq. Otherwise testamentary gifts are funded in the following order of priority, from highest priority to lowest, under the provisions of CPC § 21402:

1. Specific gifts to the transferor's heirs at law;
2. Specific gifts to recipients other than the transferor's heirs at law;
3. General gifts to the transferor's heirs at law;
4. General gifts to recipients other than the transferor's heirs at law;
5. Residuary gifts; and
6. Property not disposed of by the testamentary instrument.

For example: Donald's Will provides that at his death his nephew Huey is to be given his Ford Mustang, his nephew Louie is to be given $100,000, and his nephew Dewey is to be given anything left over. When Donald dies his probate estate (after payment of debts and taxes) contains the Ford Mustang and $80,000 in other assets. Huey will receive the Ford Mustang because that is a specific gift to an "heir at law", and that has the highest priority. Louie will get the remaining assets $80,000 because that is a general gift to an "heir at law". Dewey will get nothing because his "residuary" gift is of lower priority. Dewey's gift has "**lapsed by abatement**".

16. Exoneration

The term "**exoneration**" means the transfer of a specific gift from the estate of a decedent to a recipient (donee) free of debt.

As a general rule specific gifts pass to recipients subject to any mortgage, deed of trust or other lien existing at the date of death without any right of exoneration, even if the terms of a Will or Trust state a "general directive to pay debts" of the decedent. (CPC § 21131.)

However, if a Will or Trust specifically states that the decedent's executor or successor trustees are to pay mortgages, deeds of trust or liens before specific gifts are distributed, the gift will be distributed free of debt.

For example: Donald's Will states, "My executor is to pay all of my debts … My house is to be given to Huey". Huey will receive the house subject to any mortgage, deed of trust or lien that exists at Donald's death because the Will only states a "general directive to pay debts and does not specifically direct that the mortgages, deeds of trust or lien on the house are to be paid.

Chapter 6: Probate Distribution without Administration

An understanding of the basic probate process and basic rules, terms and concepts is necessary to understand the principals of Wills and Trusts.

1. Passage of Property to Surviving Spouse without Administration

If a decedent dies leaving a **surviving spouse** property that is supposed to go to that surviving spouse can be transferred to them without Court administration. (CPC §§ 13500 et seq.) This is true whether the deceased spouse died intestate or testate. This provision does NOT appear to have been extended by statute to registered domestic partnerships.

If deceased spouses die intestate the surviving spouses have a right to receive the deceased spouses' half of all community property and a portion of the deceased spouses' separate property. That will be explained in more detail in a following chapter on "intestate succession".

If the deceased spouses die testate the surviving spouses have a right to receive the gifts that the deceased spouses provided for them in their Wills.

In either case surviving spouses can petition the Probate Court for a determination that they have a legal right to receive the properties of the deceased spouses. This may involve a determination that the property sought was community property and the deceased spouse died intestate. Or it may involve a determination that the deceased spouse died testate and provided in the Will that the surviving spouse get the property sought. These are called "**Spousal Property Petitions**" and they are almost always needed if the probate estate includes real property because it clears title.

Although Spousal Property Petitions involve a Court hearing and some expense, they are far less costly and time consuming than a probate action "with Court administration".

> **For example:** After years of stormy marriage Jose and Amelia separated temporarily. During that time Jose bought a house telling the lender he was single because he was mad at Amelia. Jose later died intestate. Since the house was community property (acquired during marriage and not by gift, inheritance or devise) Amelia has a right to receive full title to the house without Court administration. But to establish that right (and avoid creating a cloud on the title) Amelia must file a Spousal Property Petition. The Court will issue an Order stating that the house belongs to Amelia. When filed with the County Recorder that Order has the same legal effect as recording a Deed.

Of course if husbands and wives own real property as **joint tenants** or as **community property with right of survivorship** the property automatically transfers to the surviving spouse and in that case <u>no Spousal Property Petition</u> is necessary. The surviving spouse only has to record an **Affidavit of Death** with the County Recorder to receive clear title. These may also be called "Affidavit of Death of Joint Tenant" or "of Trustee" as the case may be.

When spouses hold property as "community property" or as "community property with right of survivorship" rather than as "joint tenants" or "tenants in common" they may enjoy substantial tax benefits. That will be explained in detail in a later chapter.

2. Passage of Small Estates without Administration

There are two other situations, other than Spousal Property Petitions passing property to surviving spouses, when property of a decedent can be passed to heirs and beneficiaries "in probate" but "without Court administration". These are called "small estate" actions.

In one situation the decedent must have a <u>gross probate estate in California is worth no more than $100,000</u>. Personal property can be obtained by affidavit and real property by Court determination.

In the other situation it does not matter how large the decedent's gross estate is as long as the <u>total value of real property in California is worth no more than $20,000</u>. Real property can be obtained by affidavit.

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A. Gross Probate Estates Up to $100,000

If a decedent dies leaving a probate estate of <u>no more than $100,000 in California</u> (which may contain both personal and real property) both the **personal property** and the **real property** of the probate estate can be passed to intestate heirs or beneficiaries of a testate decedent's Will without Court administration.

Under CPC § 13050 the following assets are <u>excluded</u> from the probate estate for purposes of determining if it is no more than $100,000:

- Assets **outside California**;
- Assets **transferred to a surviving spouse** pursuant to CPC §§ 13500 et seq.
- Assets held in **joint tenancy**;
- **financial accounts** that were:
    - **co-owned** with a surviving party;
    - **payable on death** (POD); or
    - **payable to a beneficiary**;
- **Vehicles**;
- **Vessels**;
- **Mobile homes**;
- **Manufactured homes**;
- **RVs**;
- **Commercial coaches**;
- **Camper shells**; and
- **Floating homes**.

1) Obtaining Personal Property by Affidavit

Heirs and beneficiaries with a right to receive **personal property** from the estate of a decedent with a gross estate no more than $100,000 (as defined above) can collect it from those holding it (both in and outside California) based on a **sworn affidavit** and **without any Court action** if at least 40 days have passed since the death. (CPC §§ 13100 et seq.) This involves nominal expense.

The "personal property" to be collected can be money the decedent had a right to receive, tangible personal property of the decedent, or debts, obligations, securities, interest, or other financial or legal rights of the decedent.

The "facts" that must be sworn to in the affidavit include the decedent's name, the date and place of death, that over 40 days have passed since the death, that either no "regular" probate action has been started or else that the personal representative of the estate (i.e. the Court approved executor, executrix or administrator) has given written consent to the transfer of personal property, a right to receive the property and that the probate estate of the decedent does not exceed $100,000.

> **For example:** Hal dies owning a house in California worth $400,000, a bank account in California with $90,000 in it, a bank account in Nevada with $300,000 in it, and land in Texas worth $900,000. His Will says he is giving the California house to his surviving spouse Wanda, all the money in his two bank accounts to his son, Sam, and the land in Texas to his sister Tess. After Hal has been dead for 40 days Sam can go to the banks, present the required affidavits, and collect the $390,000 because Hal's property in California, excluding property that is supposed to go to the surviving spouse, Wanda, is not more than $100,000. Sam does not have to file anything in the Probate Courts, and he does not have to get any approval from a judge.

2) Obtaining Real Property by Court Determination

Heirs and beneficiaries with a right to receive **real property** from the estate of a decedent with a gross estate no more than $100,000 (as defined above) can obtain a court determination that they hold title by **petitioning the Probate Court** if at least 40 days have passed since the death. (CPC §§ 13151 et seq.) This involves less time and expense than a probate action with Court administration. This petition can also ask for a determination they hold title to **personal property** at the same time. Generally personal property can be obtained by the affidavit procedure explained above more easily than by petitioning the Court, but a Court determination may be required to obtain possession to personal property from parties outside California.

The "facts" that must be stated in the petition include the decedent's name, the date and place of death, that over 40 days have passed since the death, that either no "regular" probate action has been started or else that the personal representative of the estate (i.e. the Court approved executor, executrix or administrator) has given written consent to the transfer of real property, a right to receive the property, that the probate estate of the decedent does not exceed $100,000, the names and addresses of other heirs or beneficiaries, etc.

> **For example:** Hal dies owning a house in California worth $100,000, a bank account in Nevada with $300,000 in it, and land in Texas worth $900,000. His Will says he is giving the California house to his son, Junior, the money in his bank account to his son, Sam, and the land in Texas to his sister Tess. After Hal has been dead for 40 days Junior can petition

the Court for a determination that the house in California belongs to him because Hal's property in California is not more than $100,000. Sam has to file a petition in Probate Court and obtain an Order that he holds title to the house. If he records that Order with the County Recorder he perfects title in his own name.

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B. Total Real Property Up to $20,000 by Affidavit

Heirs and beneficiaries with a right to receive **real property** from the estate of a decedent with total real estate holdings in California with a gross value of no more than $20,000 can obtain title to it based on a **sworn affidavit** filed with the Clerk of the Probate Court in which the decedent was domiciled at the time of death, or if the decedent was not domiciled in California at the time of death in any County where real property of the decedent is located, if at least 6 months have passed since the death. (CPC §§ 13200.)

The affidavit must state the decedent's name, the date and place of death, that over 6 months have passed since the death, that either no "regular" probate action has been started or else that the personal representative of the estate (i.e. the Court approved executor, executrix or administrator) has given written consent to the transfer of real property, a right to receive the property, that the gross value of real property in the probate estate of the decedent does not exceed $20,000, and that all funeral expenses, expense of last illness and unsecured debts of the decedent have been paid.

The calculation of the $20,000 limit for this includes all real property of the decedent within California. But it excludes all real property outside of California, all personal property, property that was held in joint tenancy or community property with right of survivorship, and property that a surviving spouse has a right to receive under CPC §§ 13500, et seq. as explained above.

This is only effective as to real property within California. If the decedent dies owning real property outside of California it is subject to the probate rules of the place where it is located (State, country) and may require an ancillary action in that place.

The Court Clerk will file the affidavit and issue certified copies of it. Recording a certified copy of the affidavit in the County where the real property is located gives purchasers the same protections as the recording of a Final Order of Distribution following a probate action.

Chapter 7: Probate Distribution with Court Administration

If the assets in the probate estate cannot be distributed pursuant to the provisions explained above they must be distributed subject to Court administration under the provisions of California Probate Code Division 7. (CPC §§ 7000 et seq.)

Under those provisions a "petitioner" must ask the Court to "open probate" and after that the probate estate must be distributed with approval from and an Order of the Court. This is called a "full probate" and it is the time consuming and expensive process people use "living trusts" to avoid.

This process takes a minimum of 8 months and the out of pocket costs generally exceed $900 (as of 2010).

1. Testate and Intestate Estates

Probate estates subject to distribution with Court administration fall into two categories: intestate decedents and testate decedents. In either case probate begins with the filing of a Petition to Open Probate of the decedent's estate.

The Probate Court will appoint an **administrator** to be in charge of distributing **intestate estates** to "**heirs**" pursuant to the provisions of the Probate Code. (CPC §§ 6400 et seq.) In that case the distributions are said to be an "**inheritance**".

The Probate Court will appoint an **executor** (or **executrix**) to be in charge of distributing **testate estates** (the estates of "**testators**") to "**beneficiaries**" pursuant to the terms of the testator's Will. In that case the distributions are said to be "**by devise**" rather than an "inheritance" but that distinction if frequently lost or ignored.

The distinctions between "beneficiaries" and "heirs" and between "by devise" and "by inheritance" are often ignored or misunderstood and you will frequently find the syntax being muddled.

2. Court Appointment of Personal Representatives

The administrators of intestate decedents and the executors (or executrixes) of testators are both referred to as the "**personal representatives**" of the estate and they must be appointed by the Court.

Individuals are entitled to appointment to be the administrators of intestate estates according to an order of preference set by law. Surviving spouses and domestic partners are given highest preference, children second highest preference, grandchildren third highest preference, etc. (CPC § 8461.)

People nominated to be executors/executrixes in a Will are entitled to be personal representatives of testate estates, but if they fails to file a petition for probate within 30 days after they learn the decedent has died, that preference is waived, absent good cause for the delay. (CPC § 8001.)

In any event the Court has discretion to grant or deny appointment of a person to be personal representative based on an assessment of their honesty, ability and reliability.

3. Duties of Personal Representatives

Personal representatives of estates are responsible for gathering ("marshalling") the assets of the estate, using estate assets to pay the debts of the decedent, sending notice to all interested parties, publishing notice of the probate in a local newspaper, and paying the costs of probate (i.e. Court filing fees, publication costs, appraisal costs and miscellaneous document costs).

4. Compensation of Personal Representatives

After personal representatives have performed all of their duties paid all of the debts of the decedent the probate action can be concluded. At that time the personal representatives have a right to be reimbursed for any costs of administration they have incurred and paid "commissions" in compensation for acting in their capacities. Reimbursement and payment of commissions requires approval of the Court (judge).

If the decedent died **intestate**, the personal representative ("administrator") can demand a commission in the amount set by CPC § 10800, and the judge is required to approve it.

The amounts set by CPC § 10800 are as follows:

4% of the first $100,000 of the probate estate
3% of the next $100,000
2% of the next $800,000
1% of the next $9 million
½% of the next $15 million, and
"a reasonable amount to be determined by the Court" beyond that.

If a decedent dies **testate** the personal representative ("executor / executrix") has a right to be compensated according to CPC § 10800 <u>unless the Will expressly sets compensation to a lower amount.</u>

5. Selection and Compensation of Attorneys

Personal representatives are authorized to choose attorneys to represent them, and to negotiate the attorneys' fees. Attorney fees for probate actions are negotiable as for any other action. Written retainer agreements are almost always required because the fee will almost always exceed $1,000, and under California Business and Professions Code section 6148 a written retainer agreement is mandatory in that situation.

Attorneys cannot accept payment of any attorney fees without the approval of the Court (judge). That generally happens when the probate is concluded. However, attorneys that are concerned they will never be paid their costs and fees after concluding a probate action can require a retainer to be put in their **client trust account** to assure payment of those amounts. As costs are incurred the attorney can pay the costs out of the client trust account. But the attorney cannot take any attorney fees from the client trust account until the Court approves the fees and orders them to be paid. Violation of this procedure will subject an attorney to discipline by the California Bar.

At the conclusion of the probate process judges are required by law to approve attorney fees, without question as to their "reasonableness", if they are no more than a statutory amount based on the gross size of the probate estate (CPC § 10810).

The amounts set by CPC § 10810 are as follows:

4% of the first $100,000 of the probate estate
3% of the next $100,000
2% of the next $800,000
1% of the next $9 million
½% of the next $15 million, and
"a reasonable amount to be determined by the Court" beyond that.

6. Distribution of Residual of Estate

After all debts of the decedent have been paid, the personal representative has been paid "commissions" and reimbursed for the costs of administration, and the personal representative's attorneys' have been paid their fees reimbursed for the costs of administration, the Court will order the residue of the estate to be distributed to the "**heirs at law**" (for intestate distribution) or "**beneficiaries**" (for distribution by a Will).

When that has been completed and signed receipts filed with the Court, the Court will issue an Order excusing the personal representative from all further duties.

Chapter 8: Distribution by Intestate Succession

To understand the benefits of estate planning, including the use of Wills and Trusts, it is important to first understand what happens in the absence of estate planning, **intestate succession** as set forth in CPC §§ 6400 et seq.

1. Probate of an Intestate Estate

An intestate estate is subject to all of the rules explained in the prior chapters. If the probate estate can be passed to the heirs without Court administration there is no need to conduct a "full probate" with Court administration, and otherwise the probate estate must be distributed with Court administration according to CPC §§ 7000 et seq.

2. Appointment of Administrator

After a petition for probate has been filed the Court will appoint an administrator (personal representative) of the estate as explained in the prior chapter on distribution with Court administration. The order of preference for appointment of an administrator is set forth in CPC § 8461. Surviving spouses have highest priority, children second, grandchildren third, etc.

The Court will decline to appoint a person who does not appear to be honest, reliable, and capable.

3. Distribution of an Intestate Estate

The entire probate estate of an intestate decedent is distributed by the rules of intestate succession. But part of it might be distributed without Court administration and the rest with Court administration. For example, part of the probate estate might be given to the surviving spouse without Court administration based on a Spousal Property Petition and the rest may be distributed to other heirs with Court administration.

4. Distribution of Residual from Flawed Will

It is also possible for a decedent to die testate with a valid but flawed Will that fails to provide for distribution of the **residual** of the probate estate. The residual is the amount left over after all express conditions of the Will have been followed. In this case the residual is distributed according to the rules of intestate succession

> **For example:** Hal dies with a Will that just says, "I leave Blackacre to my wife Wanda." But suppose before Hal dies he inherits Whiteacre from his brother. Since Hal's Will did not provide for distribution of any residual (Whiteacre) it will have to be distributed according to the rules of intestate succession, even though Hal did not actually die intestate.

5. The Rules of Intestate Distribution

The intestate distribution of a probate estate in California depends on whether the property to be distributed is classified as the **separate property** of the decedent under the California Family Code or not. Consequently, the provisions of the California Probate Code and the California Family Code are inextricably intertwined. You cannot understand the rules of intestate distribution without understanding the rules of California Community Property.

All property owned by unmarried people at their death is their separate property.

Property held by married people at their death that was acquired before marriage, acquired after permanent and final separation, or acquired during marriage by gift, inheritance (via the rules of intestate succession) or devise (via a Will or Trust) is also presumed to be their separate property.

All other property acquired during marriage by a person who is still married at their death is presumed to NOT be their separate property. Typically this is called "community property" but actually it can be **community property**, **quasi-community property**, or **quasi-marital property**. There are fine distinctions between those categories, but they don't matter. All you need to know is that all properties in these categories go to the surviving spouse under the rules of intestate succession.

For a more complete explanation of California Community Property see Nailing the Bar's "Simple California Community Property Outline".

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A. Intestate Distribution of Community Property to Surviving Spouse

If married people die intestate their interest in **community property** all goes to their surviving spouses. And this property can be transferred to the surviving spouse without Court administration under the provisions of CPC §§13500 et seq. At the current time this has NOT been extended to domestic partnerships and there is no "community property" in that situation.

Since each spouse has an inchoate interest in HALF of the community property this effectively means the surviving spouse keeps one half and acquires the deceased spouse's other half of all community property.

Quasi-community property and **quasi-marital property** is treated the same as community property so this rule really applies to "**all non-separate property**". But it is simply easier to say "community property" rather than "non-separate property".

> **For example:** Hal dies without a Will while married to Wanda, and during marriage they bought a house together in California with title stated to be "community property". Hal also inherited a farm in California from his mother. Since Hal and Wanda did not hold title to the house as "joint tenants" or "community property with right of survivorship" this house does not pass to Wanda outside of probate and will be subject to the "probate process". But the house is community property, and under the rules of intestate succession it goes to Wanda without Court administration. She would just have to file a Spousal Property Petition to get clear title to the entire house. The farm that Hal inherited from his

mother would be Hal's separate property because it was an "inheritance". Wanda would not automatically get title to that and it would be subject to the rules explained in the next section.

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B. Intestate Distribution of Separate Property

Intestate distribution of **separate property** of a decedent depends on whether they were survived by a spouse (or registered domestic partner). Surviving spouses and domestic partners receive some or all of the separate property of the decedent and the balance is distributed to issue, parents, siblings, grandparents and other people related to the decedent as explained below.

1) Intestate Share of Separate Property to Surviving Spouse or Domestic Partner

Under CPC § 6401(1) the separate property of an intestate decedent is distributed to the decedent's surviving spouse or registered domestic partner as follows:

1. ALL of the decedent's separate property goes to the surviving spouse or domestic partner if the decedent <u>was not survived by any issue</u> (no direct lineal descendents), by <u>either parent</u>, or by <u>any issue of the parents</u> (no brothers, sisters, nieces, nephews, etc.) This can be rephrased to simply say that if the decedent is the <u>last living descendent</u> of the decedent's parents, all the decedent's separate property goes to the surviving spouse or domestic partner.

    For example: Hal dies intestate while in a registered partnership with Rob, and at his death Hal owned a farm in California. If Hal was the last living descendent of his parents, Rob gets the farm.

2. HALF of the decedent's separate property goes to the surviving spouse or domestic partner if the decedent <u>was survived by ONE child or the issue of just ONE child</u> OR by <u>either or both parents</u> OR by <u>any issue of the parents</u>.

    For example: Hal dies intestate while in a registered partnership with Rob, and at his death Hal owned a farm in California. When Hal dies his nearest living relative is his nephew Norman, son of his dead brother Tom. Rob gets half the farm.

3. ONE-THIRD of the decedent's separate property goes to the surviving spouse or domestic partner if the decedent <u>was survived by TWO OR MORE children</u>, OR by <u>ONE child and the ISSUE of ONE OR MORE OTHER predeceased children</u>, OR by the <u>ISSUE of TWO OR MORE predeceased children</u>.

    For example: Hal dies intestate while in a registered partnership with Rob, and at his death Hal owned a farm in California. When Hal dies he is survived by his son John and five grandchildren born to his predeceased son Sam. Rob gets one-third of the farm.

2) Intestate Distribution to Decedent's Issue

Under CPC § 6402 all separate property of an intestate decedent that is not distributed to a surviving spouse or registered domestic partner as explained above is distributed **per stirpes** <u>to the decedent's issue</u>, if any are living.

This **is heavily tested**. The remaining intestate distribution rules below are **not heavily tested** but it is always possible they will be.

3) Intestate Distribution to Decedent's Parents

The separate property of an intestate decedent that is not otherwise distributed as explained above is distributed <u>to the decedent's surviving parents</u> **equally** or **all to one** parent if only one is alive, subject to a possible exception explained in the next section below.

> **For example:** Able dies intestate and unmarried leaving an estate of $300,000. Able is not survived by any issue (descendents). His mother Wilma is also dead but his father, Zeke, is alive. Zeke will receive all of the property unless the exception explained immediately below applies.

4) Intestate Distribution to Heirs of Predeceased Spouse

Under CPC § 6402.5 there is an unusual exception for intestate distribution of the probate estate of a decedent that 1) <u>has no surviving spouse</u> (surviving domestic partners do not count) and 2) <u>no surviving issue</u>, if 3) a portion of the <u>probate estate of the decedent is attributable to a predeceased spouse of the decedent who died within the prior 15 years</u>.

In this case the portion of the probate estate of the decedent attributable to the predeceased spouse is distributed according to these same **rules of intestate succession** <u>as if it were still the predeceased spouse's property</u>, not as if it were the property of the decedent. This is a seldom applied exception and usually ignored or tested. But it is a strange rule that can produce unexpected results.

> **For example:** Able was married to Wanda, and she had a son named Damien from a previous relationship. Wanda owned stock worth $100,000 as her separate property, and when she died she disinherited Damien in her Will and gave the stock to Able. Ten years later Able died intestate, leaving a probate estate of $300,000, including the stock he had received from Wanda. Able was not survived by any issue (descendents), and his closest living relative is his father, Zeke. Normally Zeke would get Able's entire estate. But since Wanda had been dead for less than 15 years, and Able died intestate and without issue, the stock will be distributed as if it still belonged to Wanda and she had just died intestate. That will cause the stock to go to Damien, even though Wanda previously disinherited him in her Will. The other $200,000 in Able's probate estate would go to his father, Zeke.

5) Intestate Distribution to Issue of Parents

The separate property of an intestate decedent that is not otherwise distributed as explained above is distributed **per stirpes** to the living issue of the decedent's parents in the same manner it would have been distributed if it had been the decedent's parents' property.

> **For example:** Able dies without a Will and $300,000 of his separate property is not distributed to his surviving spouse or registered domestic partner. Able is not survived by any issue and his parents are both dead. The property will be distributed to his parents' living issue (their direct lineal descendents, Able's brothers, sisters, nieces, nephews, etc.) **per stirpes**.

6) Intestate Distribution to Grandparents

The separate property of an intestate decedent that is not otherwise distributed as explained above is distributed to the decedent's surviving grandparents **equally** or **all to one** grandparent if only one is alive, subject to the exception established by CPC § 6402.5 explained above.

> **For example:** Able dies without a Will and $300,000 of his separate property is not distributed to his surviving spouse or registered domestic partner. Able is not survived by any issue, his parents are dead, and there are no living issue of his parents. The property will be distributed to his grandparents if any are alive.

7) Intestate Distribution to Issue of Grandparents

The separate property of an intestate decedent that is not otherwise distributed as explained above is distributed to the decedent's grandparents' living issue **per stirpes** subject to the exception established by CPC § 6402.5 explained above.

> **For example:** Able dies without a Will and $300,000 of his separate property is not distributed to his surviving spouse or registered domestic partner. Able is not survived by any issue, his parents are dead, there are no living issue of his parents, and his grandparents are all dead. The property will be distributed to his grandparents' living issue, if any.

8) Intestate Distribution to Issue of Pre-Deceased Spouses

The separate property of an intestate decedent that is not otherwise distributed as explained above is distributed to the issue of the decedent's predeceased spouses, if any, **per stirpes** subject to the exception established by CPC § 6402.5 explained above.

For this provision (CPC § 6402(e)) to take effect, it would require the intestate decedent to be unmarried and not a registered domestic partner at the time of death, AND the last living descendent of all four predeceased grandparents.

Note that CPC § 6402.5 only applies to property of the decedent that is attributable to a predeceased spouse who died within the past 15 years, but may apply even if the decedent's parents, grandparents or the issue of parents or grandparents are still alive. Further, it provides for distribution to any intestate heir of the predeceased spouse, which might include the predeceased spouses' parents, siblings, grandparents, etc.

In contrast, this rule (CPC § 6402(e)) applies to all separate property and regardless of when the predeceased spouse(s) died, but will not apply if the decedent's parents, grandparents or the issue of parents or grandparents are alive. Further, this rule only provides for distribution to the predeceased spouses' issue.

> **For example:** Able was first married to Frieda, and she had a son named Damien from a previous relationship. Frieda died, and then Able married Susan who owned stock worth $100,000 as her separate property. Susan despised her closest living relative, her sister Nancy. After 20 years of marriage Susan died and gave her stock to Able in her Will. Ten years later Able died intestate, leaving a probate estate of $300,000, including the stock he had received from Susan. Able was the last living descendent of all his grandparents. Since Susan had been dead for less than 15 years, and Able died intestate and without issue, the stock will be distributed as if it still belonged to Susan and she had just died intestate. That will cause Susan's stock to go to Nancy, pursuant to CPC § 6402.5, even though Susan despised her and had willed the stock to Able. The remaining $200,000 in Able's probate estate would go to Damien, the issue of Able's late wife, Frieda, even though she died over 30 years earlier.

9) Intestate Distribution to Other Next of Kin

The separate property of an intestate decedent that is not otherwise distributed as explained above is to any of the decedent's other blood relatives, if any, with preference to the nearest ancestors to receive **per stirpes**.

10) Intestate Distribution to Predeceased Spouse's Parents and their Issue

The separate property of an intestate decedent that is not otherwise distributed as explained above is to the living parents of any predeceased spouse or to the living issue of the predeceased spouse, if any, **per stirpes**.

11) Escheat of Unclaimed Intestate Probate Estates to the State

If an intestate decedent dies without issue, separate property that is not otherwise cannot be distributed in the manner explained above will escheat to the State. (CPC § 6404.)

12) Summary of Intestate Distribution Rules

Although the above intestate distribution rules may seem daunting, the first rule about descent to issue of the decedent, and the per stirpes distribution are about all that is ever tested, either in law school or on Bar exams.

6. Advancements

Under CPC § 6409 If people die intestate as to all or part of their probate estates, lifetime gifts to heirs at law are treated as **advancements** if, and only if:

1. The decedent declared in writing, at the time a gift was given that it was an advancement or to be deducted from that heir's intestate inheritance when the decedent dies; OR

2. The heir acknowledged in writing at any time that the gift was an advancement or to be deducted from the heir's share of the estate when the decedent died.

   For example: Able has two children, Bob and Charles. Bob asks him for a $10,000 loan. Able says, "I will just give you the $10,000, and then when I die it is to be taken out of your share of my estate." Bob agrees. Later Able dies intestate leaving a probate estate of $150,000. So how much does Bob inherit? He and Charles both inherit $75,000. Why? Because they didn't put it in writing.

   For example: In the same example immediately above, suppose they did put it in writing. Then how much would they get? Bob would get $80,000 and Charles would get $70,000. Since Charles had already gotten $10,000 earlier, that means each of them ended up with an equal amount overall, $80,000. To figure this out, divide the amount of the advancement ($10,000) by the number of shares the estate is divided into later (2 shares here, one for Bob and one for Charles) to determine the adjustment amount ($5,000). Then reduce the share of the party that received the advancement (Bob) by that amount, and increase the shares of all the other heirs (Charles) by the same amount.

If the recipient of an advancement against an estate dies before the decedent (the person from whom they expected to inherit from) the advancement is not taken into account when determining the amounts their issue would receive unless that is stated as a condition in the writing that proves the advancement.

   For example: Able has two children, Bob and Charles. Charles asks him for a $50,000 loan. Able says, "I will just give you the $50,000, and then when I die it is to be taken out of your share of my estate." Charles agrees, and Able signs a statement at the time that says, "I am giving Charles $50,000 now but it is to be deducted from his share of my estate when I die." Suppose Charles dies before Able, leaving two children, Eva and Fred. Then if Able died intestate after that leaving a probate estate of $300,000, how will Able's estate be divided? Bob gets $150,000 and Eva and Fred each get $75,000. Why? Because even though Able stated in writing that the $50,000 loan to Charles was to be deducted from his share of the estate, he didn't say in the same writing that the loan was to also be deducted from any shares left to Eva and Fred.

A
(decedent)

B ($150k) C (dead)

D E ($75k) F ($75k)

7. Offsets for Debts against Intestate Shares

If an intestate heir owes a decedent a debt, the debt is deducted from the intestate share of the heir in settling the estate.

> **For example:** Able has two children, Bob and Charles. Bob asks him for a $10,000 loan. Able agrees and loans him the money. Later Able dies intestate leaving a probate estate of $150,000. So how much does Bob inherit? He gets $70,000 and Charles gets $80,000. Why? Because Bob owed Able $10,000 and if he is forgiven of that debt and given $70,000 he is effectively being given $80,000, the same amount Charles was given.

But under CPC § 6410 the debt cannot be deducted from the intestate share of any other heir, and if the debtor dies before the decedent, the debt owed by the debtor is not deducted from the intestate shares of the debtor's issue.

> **For example:** Able has two children, Bob and Charles. Charles asks him for a $50,000 loan. Able agrees and loans him the money. Suppose Charles dies before Able, leaving two children, Eva and Fred. Then if Able died intestate after that leaving a probate estate of $300,000, how will Able's estate be divided? Bob gets $150,000 and Eva and Fred each get $75,000. Why? Because even though Charles owed Able $50,000, he died before Able. The share of Able's estate that passes to Eva and Fred cannot be reduced to reflect a debt of Charles, even though Eva and Fred take their shares through Charles.

Chapter 9: Will Creation

Wills are simply documents that say **testators** (people executing Wills) want their **probate estates** to be distributed to certain **beneficiaries** after the testators have died. They are defined and controlled by California Probate Code Division 6 (CPC §§ 6100 et seq.)

1. Wills are Often Worthless

Wills are often not worth the paper they are written on because they provide no benefit to the testators. The reason is the majority of testators want their estates to descend to their children in equal shares, and that is exactly what would have happened through intestate succession whether they have a Will or not.

> **For example:** Tess, a widow, goes to a lawyer to draft a Will. At her death she wants her probate estate to go to her adult children in equal shares. But that would have happened anyway (through intestate succession) so her Will has no legal effect.

2. Will Execution Requirements

Under California law all Wills must meet basic legal requirements:

1. The testators must **have testamentary capacity**;
2. The testators must be **acting voluntarily** and not as a result of duress or undue influence;
3. The Wills must be **written**;
4. The Wills must be **signed by the testator** or by **someone acting at the request of the testator** in a situation where the testator is physically unable to sign; and
5. Wills, on their face, must **manifest testamentary intent** on the part of the testator.

These "basic legal requirements" are **frequently tested**.

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A. Testamentary Capacity

All adults are presumed to have testamentary capacity. That is a rebuttable presumption. Typically if a testator can answer the following questions, posed to them by their attorney at the time they execute their Will, the presumption of testamentary capacity is virtually impossible to rebut:

- What is year is it?
- Where do you live?
- Who is the President of the United States?
- Are you married? What is your spouse's name?
- Do you have any children? What are their names?
- Do you have any grandchildren? What are their names?

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B. Undue Influence and Certificates of Independent Review

All testators are also presumed to be acting free of undue influence. This is a rebuttable presumption. If testators meet with attorneys alone and confirm they are drafting the provisions of their Wills voluntarily, and the attorney **or anyone related to them by blood, marriage, financially or professionally** is not being named as a beneficiary of the Will, that presumption is virtually impossible to overturn unless the testator was previously found to be mentally incompetent in a Court of law. This is **frequently tested**.

On the other hand, if the attorney (or other person) who drafts a Will or someone related to them is a named beneficiary, undue influence and/or fraud are presumed by law unless another, unrelated, attorney meets with the testator in private, confirms the document reflects the true intentions of the testator, and executes a **Certificate of Independent Review** attesting to that fact. When undue influence and/or fraud are presumed by law the gift stated in the Will is void to the extent it exceeds the intestate share the same beneficiary would have received.

> **For example:** Tess, a widow, goes to Larry Lawyer to draft a Will. She asks for her Will to give Larry a gift at her death. Larry has his law partner, Al Attorney, meet with Tess alone. Al then executes a Certificate of Independent Review stating that Tess was not acting under undue influence. The Certificate executed by Al is worthless because Al is related to Larry through their professional partnership. So at Tess' death Larry will get no more than an intestate share of her estate.

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C. Manifestation of Testamentary Intent

The phrase "**manifest testamentary intent**" simply means Wills must show the testators intended to distribute their probate estates to named beneficiaries at their deaths, to nominate executors to supervise the distributions, to nominate guardians to care for the testators' minor children, and/or to nominate custodians to manage the shares of minor children until they become adults.

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D. Multiple Wills

If a testator that has previously executed one or more valid Wills subsequently executes yet another valid Will without revoking all prior Wills, all the Wills are simultaneously valid. But if portions of later dated Wills contradict the provisions of earlier dated Wills, the later Wills supersede the conflicting provisions of the earlier Wills.

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E. Undated Wills

Wills **do not have to be dated**, but they should be. If Wills are undated, and the lack of a date causes ambiguity compared with other Wills of the testator, the ambiguity will be resolved against the undated document.

For example: Tess executes valid Will dated 2006 that says, "I revoke all prior Wills". But when she dies an undated valid Will is found that says, "I revoke all prior Wills". The undated Will fails unless the wording on the face of it or extrinsic evidence (e.g. testimony by witnesses) proves it was executed after the dated Will.

3. Naming Executors

Wills almost always nominate one or more people to be the **executors** of the Will ("**executrixes**" in the feminine), and that means the people who will be in charge of paying off the debts of the deceased testator and distributing the remaining assets to the beneficiaries. Named executors have no obligation to serve and may decline to serve.

The powers of executors set forth in statute are the same as the powers of administrators of intestate estates. But the provisions of a Will can alter that.

The duties of executors, how they are appointed by the Court, and their compensation were explained earlier in the chapter on "probate basics".

This is **seldom tested**.

4. Naming Guardians

A Will can also nominate one or more people to act as **guardians** to care for the minor children of the deceased testator.

People nominated to be guardians must be confirmed by the court the same as executors

People nominated to be guardians will not be confirmed by the Court (i.e. the judge) if it would not be in the best interest of the children. This would usually be because the person nominated is physically, mentally or financially unable to care for the minor children or else because they have a history of criminal activity.

This is **never tested**.

5. Naming Custodians

A Will can also nominate one or more people to act as **custodians** to care for the share of the probate that is to be distributed to the minor children of the deceased testator. Often people nominated to be guardians are also nominated to be custodians.

People nominated to be custodians over the estate shares of the deceased testator's children must also be confirmed by the court.

The people nominated to be custodians will not be confirmed by the Court (i.e. the judge) if it would not be in the best interest of the children the same as guardians.

This is **never tested**.

6. Holographic Wills

Under the California Probate Code two types of Wills are legal, **holographic** Wills and **attested** Wills. Holographic Wills are **handwritten** Wills, written by testators <u>in their own handwriting</u>. They do not have to be entirely handwritten. Substantial parts of the Will can be typewritten or printed, and a printed "Form Will" is legal as long as <u>the portions showing testamentary intent</u> are handwritten by the testator. The phrase "**testamentary intent**" means <u>what</u> is to be given at the death of the testator and <u>to whom</u> it is to be given.

This is **frequently tested**.

> **For example:** Tess goes to a stationary store, buys a printed "Form Will" and fills it out in her own handwriting (longhand script). When she is done it says,
>
> > "I <u>*Tess*</u>, being of sound mind and not under duress or undue influence declare this to be my Last Will and Testament.
> >
> > Upon my death I give the following gifts:
> >
> > 1. <u>*My house at 123 Elm Street to my friend Benny*</u>,
> > 2. <u>*My bank accounts to my niece Reese."*</u>
> >
> > Signed <u>*Tess*</u>.
>
> That is a legally sufficient holographic Will because the portions that show <u>testamentary intent</u>, what is to be given and to whom it is to be given are in Tess' own handwriting.

Holographic Wills <u>do not have to be witnessed</u> by anyone, and witnessing a holographic will is a meaningless act unless it is witnessed in a manner that qualifies it to be an attested Will.

7. Attested Wills

Attested Wills are those that **do not qualify to be a holographic Wills**. That means that if the major (dispositive) provisions of a Will are not written in the handwriting of the testator it must be "attested to" by witnesses and is an "attested Will". Otherwise it is not valid.

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A. Required Witnessing Procedure

Attested Wills (those that must be signed by witnesses who "attest" to the validity of the document) must be signed pursuant to statutory requirements <u>unless</u> it is shown by <u>clear and convincing evidence</u> that the testators intended for the document to be their Will at the time they executed it. If neither of these requirements are met the Will is not valid.

This is the most frequently tested issue on "Wills" exams, and the exception for "clear and convincing evidence" was added to the Probate Code beginning 2009.

Attested Wills **usually must be signed** by two (2) or more competent adults. And they both must be present, together and at the same time when they see, hear or otherwise perceive the testator knowingly sign or otherwise acknowledge the document was their Will. The witnesses must afterward sign the Will attesting to these facts.

> **For example:** Tess writes out her Will on her computer, takes it to Wit, says "I need for you to sign my Will", and asks him to witness it. He signs the Will. Then she takes it to Ness, says "I need for you to sign something". And he signs the Will. It is not a valid Will for two reasons. First, Wit and Ness were not together at the same time when they heard Tess say it was "her Will". Secondly, Tess never told Ness it was "her Will" anyway.

The exception for Wills that are not properly witnessed but can be shown with "clear and convincing evidence" to be intended to be a Will by the testator opens the door to a an exam "fact pattern" in which, for some strange reason, there are several witnesses present when a will is signed but the witnesses do not sign the Will at that time. Be alert for that.

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B. Conscious Presence Doctrine

Under the **Conscious Presence Doctrine** the witnesses to an attested Will do not have to see the testator sign the Will, but they do have to **be present and consciously perceive the testator act** in a manner that manifests an intent to execute or acknowledge the document is their Will.

This is **frequently tested**.

> **For example:** Attorney Al asks his office assistant, Pearl, to come into his office to witness Tess as she signs her Will. In the office Al asks Tess, "Is this your Will?" Tess laughs and says, "Don't be silly." She then signs the document in front of her. Al and Pearl then sign the Will as witnesses. The fact that Tess did not say, "Yes" is inconsequential. Al said the document was Tess' Will, in the presence of both Pearl and Tess, and then Tess acknowledged that fact by signing it.

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C. Attorney can be Witness

An attorney can (and should) be a witness to all Wills he drafts for clients. For some reason attorneys often avoid this. But there is no legal reason for that and several good business reasons to be a witness. If nothing else it puts your name, address and phone number on the Will so you can get referrals in the future.

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D. Handwritten Wills that Must be Witnessed

Often it is said that attested Wills are "type-written Wills", but that might not always be true. A Will that is handwritten by someone other than the testator must be witnessed like any other attested Will, unless the "clear and convincing evidence" exception applies.

> **For example:** Tess has suffered a stroke so she asks Mary to write her Will for her. Mary handwrites the Will as directed by Mary. Since Tess is not writing it in her own handwriting it must be witnessed the same as any other attested Will <u>unless</u> the Mary and other witnesses present <u>clear and convincing evidence</u> that Tess intended for this to be her Will.

This was not often tested in the past but **may be tested now** because of the 2009 change in law.

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E. "Notarizing" Wills is a Waste of Time and Money

Signing an attested Will before a Notary Public has no legal effect and does not make the Will valid or invalid. It is simply a silly waste of time and money. A notary can be one of the <u>two or more competent adult witnesses</u>, but the fact that they are a "notary" is totally irrelevant.

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F. Original Wills, Duplicate Originals, and Copies of Wills

An original Will (one with an original signature) has priority in a probate action over a mere copy of the original. If the original has been lost, a copy of the original can be legally effective, but certain "lost Will" procedures must be followed to prove to the Court that the copy is bone fide. That is explained below.

Sometimes testators sign two or more copies of their Will and those are called "duplicate originals". Any duplicate original Will has the effect of an original Will.

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G. Effect of Interested Witnesses

As stated above, a Will must be witnessed by <u>two or more adult witnesses</u>. Those <u>witnesses do NOT have to be "disinterested" for the Will to be valid</u>. (CPC § 6112 (b).) The term "**disinterested**" means the witnesses do not receive any direct benefit from the provisions of the Will, and neither does anyone else who is closely related to them by blood, marriage, financially or by business affiliation.

But if there are not <u>two or more disinterested</u> witnesses, there is a presumption of duress, menace, fraud or undue influence as to the gifts provided in the document to the interested witnesses or those related to them. That limits the gifts that could be received by them to <u>no more than an intestate share</u>. (CPC § 6112 (c), (d).) This is **often tested**.

> **For example:** Tess, an unmarried woman, executes a Will witnessed by her attorney, Al, Al's secretary, Della, and Tess' daughter, Mary. The Will gives two-thirds of Tess' estate to Mary and the balance to Mary's only sibling, Tom. Since Mary witnessed the Will, she is an interested witness. And she is receiving more than an intestate share because if Tess died without a Will Mary would only receive half of her estate rather than two-thirds. But as long as both Al and Della are disinterested witnesses, fraud is NOT presumed, and Mary will receive two-thirds of the estate as if she never witnessed the Will at all.

8. Integration Doctrine

Under the "**Integration Doctrine**" a Will may be composed of separate pieces of paper if they are physically connected (e.g. stapled, folded, kept in the same place) and or logically connected in a manner (e.g. numbered, showing a logical thought process) that comprises the whole. Obviously several pages comprise a Will when they are sequentially numbered and attached to each other. So this is more of an issue when the Will refers to separate "schedules" or is composed of somewhat unmatched pieces.

Separate **schedules** or **components** can be **incorporated by reference** if they are **clearly identified** and **exist at the time** the Will is written.

> **For example:** Tess' Will was dated 2003 and it stated, "At my death I want my assets distributed as shown on Schedule A, attached hereto and to be part of my Will." When Tess died a document was attached to the Will entitled "Schedule A" and it was dated 2004. This would NOT be incorporated into the Will under the Integration Doctrine because <u>it obviously did not exist when the Will was created in 2003.</u> Perhaps a "Schedule A" existed when Tess created her Will, and perhaps she replaced it with a new schedule created later. In any event, the new schedule does not become part of the Will, and if the rest of the Will fails to show how the estate is to be distributed, the <u>Will fails for lack of evidence of testamentary intent</u>.

9. Codicils

A **codicil** is an amendment to a Will. Codicils are only valid (effective) if they <u>by themselves meet the requirements of a valid Will</u>. And they must <u>clearly identify the Will</u> they are intended to modify. If an exam question involves a "codicil" **this is what they are testing.**

If a codicil is handwritten by a testator, and when combined with the Will they are intended to modify meet, as a whole the requirements of a holographic Will, they are valid.

> **For example:** Tess' executed a typewritten Will in 2003 that satisfied all of the requirements of a Will except that it was not witnessed. So by itself it was not a valid Will. But in 2005 she handwrote the following: "I hereby amend my Will dated June 1, 2003. I am changing my Will so that my death my entire estate is to go to Mary. Dated <u>July 1, 2005.</u> Signed <u>Tess .</u>" She then attached the handwritten codicil to the 2003 Will. This codicil is valid because it meets the requirements of a holographic will (i.e. it contains the dispositive provisions in the handwriting of the testator), and it forms a valid Will as a whole when combined with the text of the 2003 Will (meeting the requirements of the Integration Doctrine).

Otherwise codicils <u>must be witnessed in the same manner as an attested Will</u>. For this reason, it is a waste of time for any attorney to draft codicils as a practical matter instead of drafting a new Will for the client. The same formalities have to be observed as for an entirely new Will, and codicils create an unnecessary possibility of error. So it is simply bad practice for attorneys to draft codicils at all.

10. Property Subject to Testamentary Distribution

Testators have the power to distribute, through the terms of their Wills, **ALL separate property** owned by them at the time of their deaths and **HALF of the community property** and **quasi-community property** the testators co-own with surviving spouses, if any, at that time.

Testators have no legal right to give away the <u>surviving spouses' inchoate half-interest in community property and quasi-community property</u> in the testators' Wills. Further, testators have no legal right to give away their <u>inchoate interests in property held in joint tenancy</u> with other individuals in their Wills because those interests pass "outside probate".

However, testators can expressly provide that gifts of their separate property in their Wills are conditioned upon spouses and other beneficiaries waiving their rights to community property, quasi-community property and joint tenancy interests.

California law does not recognize "**dower**" or "**curtesy**" rights.

This is explained in more detail below in "Challenges Requiring Election" in the chapter on Will challenges.

11. Will Contracts

A "**Will contract**" is an agreement between two people (almost always spouses) that each will draft his or her Will with certain provisions in exchange for the same promise from the other person. It does not matter if the Wills are holographic or attested Wills. This is **not often tested**.

Will contracts become irrevocable as to the estate of the survivor as it exists when the first party dies.

> **For example:** Hal and his wife Wanda agree to execute Wills that give everything they own at their death to the survivor of them, and the survivor of them will give everything left at their subsequent death to the Church. Wanda dies first. At the time Hal has an estate of $3 million and he receives $1 million from Wanda's estate. Hal's Will is irrevocable after Wanda's death as to this entire estate, $4 million. Hal can spend the money or give it away. But he cannot change his Will to give any part of the residual to anyone but the Church. If Hal acquires additional wealth later he is free to Will the additional amounts to anyone he wants.

12. Powers of Appointment

A power of appointment is a reservation or conveyance by a person (the "**donor**") of the power or authority to distribute property of the donor at a future time to an identified class of people who are called the "**permissible appointees**". A **power of appointment** is a common law concept that is largely adopted without substantive change in California law. (CPC §§ 600 et seq.)

The property subject to a power of appointment is called the "**appointive property**". If the power is conveyed to another person, that person is called the "**donee**" of the power. Donees must be adults with testamentary (or contractual) capacity. (CPC § 625.)

A power of appointment may be stated in a Will, Trust, Deed or other written instrument and <u>is subject to all of the stated conditions of that document</u>. Here they will be explained in the context of Wills.

Powers of appointment are subject to the California Rule Against Perpetuities. (CPC § 690.)

A power of appointment in a Will is a provision that gives a donee who survives the testator the power to decide how and to whom assets from the probate estate (the "appointive property") will be distributed instead of the testator making those decisions at the time the Will is executed.

> **For example:** Tess wants some of her probate estate to be given to those people who provide her with care and comfort during the last days of her life. But when she executes her Will she does not know who those people will be or if anyone will be worthy of a gift at all. So in her Will she names her friend Eve to be executor and states, "Eve shall have the power, at her discretion, to give shares of my estate to those people who provided me with loving care and comfort during the last days of my life."

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A. Types of Powers of Appointment

A "**general**" power of appointment is one that gives donees <u>absolute discretion to keep</u> the appointive property for themselves, to use it to pay their own debts or to keep it for their own estate. All powers of appointment that are not general are "**special**" powers of appointment. (CPC § 611.) A power of appointment may be general as to some parts of the appointive property and special as to the rest.

If a donor's grant of a power of appointment requires the donee to exercise it in the <u>donee's</u> Will it is called a "**testamentary**" power. (CPC § 612.)

If a power of appointment is not subject to conditions that have not occurred and exercise by the donee can not be revoked, the power is said to be "**presently exercisable**". Any power of appointment that is not presently exercisable is "**postponed**".

If the donee is given the discretion to exercise or not exercise the power of appointment it is called a "**discretionary**" power. If the donor manifests intent that some or all of the permissible appointees be benefit from the power of appointment, even if the donor fails to exercise it, it is called an "**imperative**" power of appointment. (CPC § 613.)

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B. Exercising Powers of Appointment

In order to exercise a power of appointment the donee must **manifest intent to exercise the power of appointment** either by **express declaration** or else by **actions necessarily implying intent** to exercise the power. (CPC § 640.)

If the document creating a power of appointment states that it must be exercised in a written document with specific reference to the power or the instrument that created it, the power must be exercised in that manner.

Under California law, if donees of general powers of appointment state in their Wills that they are giving away "all" of their OWN estates it generally does NOT imply they are exercising the powers of appointment as to the appointive property in favor of their own beneficiaries unless they expressly state that they are exercising the powers of appointment.

But donees transfer interests in appointive property that the donees would have no power to transfer except by virtue of the powers they have been granted it manifests the donees intent to exercise the power. (CPC § 640.)

A residuary clause in a donee's Will does not imply exercise of a power of appointment. (CPC § 641.)

Unless the documents (or oral statement) that create powers of appointment are subject to contrary provisions, once a power of appointment becomes "presently exercisable" the donees may distribute the appointive properties to any or all permissible appointees any way they want, in any proportion, subject to conditions, in installments, etc., including by granting a new power of appointment. (CPC §§ 650-652.)

> **For example:** Tess executes a Will that names her friend Eve to be executor and states, "Eve shall have the power, at her discretion, to give shares of my estate to those people who provided me with loving care and comfort during the last days of my life." After Tess dies Eve can execute a document that says, "I hereby grant to Maria the power, at her discretion, to exercise the power of appointment that Tess granted to me in her Will." That exercises the power of appointment created by Tess by granting the same powers to Maria.

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C. Contracting to Exercise Powers of Appointment

Unless the donor specifies otherwise, a donee who has the present power to exercise a power of appointment (i.e. it is no longer revocable by the donor or subject to unfulfilled conditions) may enter into a contract with permissible appointees to exercise the power.

> **For example:** Tess executes a Will that gives Eve the power to, "…give shares of my estate to my grandchildren as you find proper." After Tess dies Eve has the legal right to enter into a contract with a grandchild, Bubba, agreeing to give Bubba Tess' entire estate in exchange for ten percent of the whole.

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D. Release of Discretionary Powers of Appointment

The donee of a discretionary power of appointment, whether general or special, can release the power by giving proper notice of that intent. (CPC §661.)

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E. Effect of Failure to Exercise Powers of Appointment

The effect of failure to expressly or impliedly exercise powers of appointments depends on whether the power is a **general** or **special** power of appointment, and if it is a special power of appointment, whether it is a **discretionary** or **mandatory** power.

1) Failure to Exercise General Power of Appointment

If a donee fails to exercise a general power of appointment an **implied appointment to the donee's estate** may be found if the donee manifested an intent for the appointive property to be disposed of as the donee's property. Otherwise it **reverts to the donor** or the donor's estate. (CPC § 672.)

2) Failure to Exercise Discretionary Special Power of Appointment

If a donee fails to exercise a discretionary, special power of appointment the appointive property **reverts to the donor** or the donor's estate unless the donor specified otherwise. (CPC § 672.)

3) Failure to Exercise Imperative Special Power of Appointment

If a donee fails to exercise an imperative, special power of appointment the appointive property is distributed in **equal shares to the class of permissive appointees** unless a different intent was stated when the donor created the power. (CPC § 671.)

13. California Rule Against Perpetuities

Gifts provided for in Wills are subject to the California Rule Against Perpetuities. (CPC § 21205.) That means that at the time the testator dies gifts provided for in the Will must necessarily vest in identifiable beneficiaries before the lapse of a time period defined by statute. "Vesting" means that an identifiable beneficiary obtains a legal right to receive the gift provided.

In California a non-vested property interest is a gift to a beneficiary who cannot be specifically identified at the death of the testator. Non-vested gifts are invalid if:

1. They are not certain to vest within 21 years after a life in being at the time the interest is created (i.e. the "common law" rule); OR
2. They are not certain to vest within 90 years after they are created.

Gifts provided for by Wills are created at the death of the testator, and the "lives in being" are the people who are alive at that time.

A class gift must vest in every member of the class within the required time frame or else the interest of every member of the class fails!

The Rule Against Perpetuities is applied against what is "possible" and not what is "probable", but without regard for modern medical advances (e.g. cryogenics). So individuals are considered to be fertile at all ages. This is often called the "fertile octogenarian" concept.

For example: Tess executes a Will in 1990 that states, "I hereby give $6,000 to my grandchildren that pass the California Bar Exam." Then Tess has a child, Sonny, in 2000 and dies at Sonny's birth. Sonny is a life in being at Tess' death. Then it is possible for Sonny to give birth to a child of his own, Diane, in 2051 when he is 51 years old. Diane is not a "life in being" because she was not alive in 2000 when Tess died (creating the gift). Then Sonny could die in 2052, and all "lives in being" at the creation of the interest (at Tess' death) have ended. Then Diane might be able to pass the Bar Exam, but not until she is 50 years old in 2100. That would be over 21 years after the interest was created, AND over 90 years after it was created. So the gift fails, and it fails from the beginning simply because this is all POSSIBLE, not because it would actually happen.

If a gift fails because it does not satisfy the California Rule Against Perpetuities, a Court must reform it as necessary to give effect to the testator's manifested intentions upon petition by an interested party. (CPC § 21220.) This is **never tested**.

14. Wills Compliant with Foreign Laws

A written Will executed in accordance with the laws in the place **where it was executed** or where the **testator is domiciled**, **has a residence** or **is a citizen** at the time of **either execution or death** is valid in California even if it is not in compliance with the execution requirements of California. (CPC § 6113.) These may be referred to as "**foreign Wills**".

For example: Tess executes a Will. She dies while residing in Mexico. Her Will is valid in California if it would be a valid Will in Mexico.

15. Deposit of Wills with Attorneys

Attorneys may retain clients' original, signed Wills for safekeeping. But that makes the attorneys responsible to keep the Wills in a safe, deposit box or vault. And if they are lost or destroyed the attorneys must notify the testator and act to replace the Wills, free of charge. Otherwise the attorneys are legally liable. (CPC §§ 700 et seq.)

So why would any attorney with common sense want to do that?

16. Wills are Private and Without Legal Effect until Death

Wills are private matters and have no legal effect until testators die. They are never recorded with County Recorders, and they generally cannot be used as evidence to prove any material fact until testators die. At that time they must be "lodged" with the Probate Court as will be explained in a later Chapter, and when that is done they become public documents.

Chapter 10: Will Revocation and Revival

Except for Will contracts, testators are free to revoke their Wills at any time, and in some situations they are automatically revoked by law. This is **frequently tested**.

1. Revocation of Wills

A Will, or any part of it, can be revoked by **stating in a subsequent Will** that the first Will, or part of it, is revoked. (CPC §6120.)

> **For example:** Hal executes a Will that states, "I hereby revoke all prior Wills." This is an effective revocation of all prior Wills.

If provisions of a subsequent Will **conflict with the provisions of a prior Will**, the provisions of the subsequent Will take effect.

A Will is also revoked if it is **burned, torn, cancelled, obliterated**, or **destroyed** by the testator, or by someone at the testator's direction, with the intent and for the purpose of revoking it. (CPC §6120.)

> **For example:** Hal executes a Will that gives his wife Wanda half his estate and the remainder to his son, Junior. Hal later says in front of several witnesses, "Junior! I hereby REVOKE MY GIFT TO YOU in my Will!!" His statement has NO LEGAL EFFECT because he did not revoke the Will in a subsequent Will, and he did not burn, tear, cancel, obliterate or destroy his Will.

If a Will or part of it is revoked by **striking out** or **erasing** the provisions, the revocation is effective whether the actions are made on the original, signed Will or on a copy of it. (CPC § 6121.)

This is **frequently tested**.

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A. Presumed Revocation

If a testators have **possession of their original, signed Wills** but after their deaths the Wills cannot be found among their belongings there is a rebuttable presumption that they revoked their Wills prior to their deaths. (CPC §6124.)

This presumption can be overcome by extrinsic evidence.

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B. Automatic Revocation upon Dissolution of Union

If testators provide for gifts to their spouses or domestic partners in their Wills, those gifts are automatically revoked by law if the marriage is dissolved or annulled or the domestic partnership is terminated. (CPC §§ 6122, 6122.1.)

> **For example:** Hal executes a Will that gives his wife Wanda half his estate and the remainder to his son, Junior. Hal and Wanda later divorce. Hal's gift to Wanda is automatically revoked by the divorce. If he dies everything he owns will go to Junior.

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C. Effect of Interlineation

"Interlineation" means that testators strike out portions of an existing Will and "write in" new provisions between the lines or on an attachment. On <u>an attested Will</u> this revokes the provisions that were "stricken out", but the <u>new provisions usually do not become part of the Will</u> because they have not been properly witnessed.

> **For example:** Hal executes an attested Will in 2004 that says, "I give half of my estate to my wife Wanda and the rest to my son Junior." In 2008 Hal strikes out the word "half" and inserts the words "two-thirds" in his own handwriting. That revokes the entire gift to Wanda and she gets nothing at all because his insertion was not witnessed and the interlineation is not a signed or sufficient to make the Will a holographic Will. The gift of "the rest" to Junior is unaffected, so <u>Junior gets everything</u>.

But if a Will is <u>holographic</u> or a handwritten attachment to a Will constitutes a <u>holographic codicil</u> this effectively modifies the Will.

> **For example:** Hal executes an attested Will in 2004 that says, "I give half of my estate to my wife Wanda and the rest to my son Junior." In 2008 Hal strikes out the word "half" and attaches a <u>signed, handwritten codicil</u> that says, "I hereby modify my 2004 Will to give two-thirds of my estate to my wife Wanda and the rest to my son Junior." This effectively would give Wanda two-thirds of the estate because this is a holographic Will that incorporates the other terms of the attested Will by reference.

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D. Effect of Revocation on Prior Wills

If a testator revokes a Will by any means, and that Will expressly revoked an earlier Will, the earlier Will remains revoked unless the circumstances or statements by the testator show that the testator intended for the earlier Will to take effect. (CPC § 6123.) This is explained further below under the **Doctrine of Dependent Relative Revocation**.

2. Revival of Wills

Revoked Wills can be "revived" in two situations.

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A. Automatic Revival upon Re-Establishment of Union

Provisions in a testators' Wills providing gifts to their spouses or domestic partners are **automatically revived** if the couple remarries or the domestic partnership is reestablished. (CPC §§ 6122, 6122.1.)

> **For example:** Hal executes a Will that gives his wife Wanda half his estate and the remainder to his son, Junior. Hal and Wanda later divorce. Hal's gift to Wanda is automatically revoked by the divorce. But later Hal and Wanda remarry. His gift to Wanda is automatically revived by the remarriage.

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B. Doctrine of Dependent Relative Revocation

If testators execute new Wills that revoke older Wills, the older (prior) Wills are revoked <u>whether or not the new Wills are themselves valid or not</u>. This is **frequently tested**.

If a Will that revokes a former Will is itself revoked, the former Will remains revoked unless the circumstances or statements by the testator show that the testator intended for the prior Will to take effect. (CPC § 6123.)

However, under the **Doctrine of Dependent Relative Revocation** (DDRR) a Court (judge) has the power to revive any prior, revoked Will if extrinsic evidence shows that would <u>give better effect to the testator's testamentary intent</u> than to distribute the estate according to the rules of intestate succession. This is also **frequently tested**.

> **For example:** Everything Hal and his wife Wanda own is community property. Hal executes a valid Will in 2008 that gives his half of the community property to his son, Junior. Later Hal and Junior have a falling out (Junior joins a commune) and Hal executes a new Will in 2009 that revokes the 2008 Will and gives all of his probate estate to Wanda. If Hal dies and the new Will is invalid (e.g. it was not properly witnessed) would the Court revive the 2008 Will under the Doctrine of Dependent Relative Revocation? No, because that would give all of his property to Junior, and they had a "falling out". Even though the second, 2009 Will is invalid, it still is **extrinsic evidence** of Hal's testamentary intent. He wanted all of his property to go to Wanda, and that is what will happen if the estate is distributed by intestate succession. Under those rules Wanda takes Hal's half of the community property, and that is what he obviously wanted. So the judge <u>would not revive</u> the 2008 Will under the Doctrine of Dependent Relative Revocation in this situation.

Chapter 11: Lodging and Proving Wills at Death

Certain procedures with respect to Wills are required by the Court when a testator dies. This is **never tested** but you should know what they are.

1. Lodging Wills

The custodian of an original Will is required to deliver it ("lodge it") with the Probate Court Clerk in the County where there is proper venue over administration of the decedent's estate within 30 days after learning of the death and send a copy of the Will to the named executor, or to the named beneficiaries if they can be located and the named executor cannot. (CPC § 8200.) This is not necessary if a petition for probate is filed before the 30 day period lapses. Otherwise, if custodians of a Will fail to do this they are civilly liable to every person injured by the failure. The term "custodian of a Will" in this context apparently means anyone who has possession of it, not a "custodian" named in a Will to manage the property of minor children of the testator.

Lodging a Will with the Court does not require payment of a fee and does not begin the probate procedure. However, it makes the Will a public record that can be viewed by the general public.

This is **never tested**.

2. Proving Wills

Facially valid Wills presented to the Court for probate must be "**proven**" to be a document that was, in fact, executed by the testator according to the requirements of law. This is **never tested**.

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A. Proving Attested Wills

A preliminary step in the probate of a Will is that it must be "proven". The Will must, on its face, be facially valid. Then some evidence must be presented to show the testator actually executed the document.

This is **never tested**.

1) Self-Proving Wills

If attested Wills contain the following "**attestation clause**" set forth in the California Statutory Will Form (CPC § 6240) above the signatures of the witnesses the Will is "**self-proving**":

> "Each of us declares under penalty of perjury under the laws of the State of California that the following is true and correct:
>
> a. On the date written below the maker of this Will declared to us that this instrument was the maker's Will and requested us to act as witnesses to it;
> b. We understand this is the maker's Will;
> c. The maker signed this Will in our presence, all of us being present at the same time;
> d. We now, at the maker's request, and in the maker's and each other's presence, sign below as witnesses;

e. We believe the maker is of sound mind and memory;
f. We believe that this Will was not procured by duress, menace, fraud, or undue influence;
g. The maker is age 18 or older; and
h. Each of us is now age 18 or older, is a competent witness, and resides at the address set forth after his or her name.

Dated: _______________."

This clause may be restated but it must contain the same basic declaration or else the Will is not self-proving and must be proven as explained above.

This is not stressed in law school or tested by the Bar. But it is basic malpractice for an attorney to draft a Will without this important boilerplate language

2) Proving Attested Wills Otherwise

If the self-proving attestation clause is not stated in the Will above the signatures of the witnesses, at least one witness who signed the Will must be located to testify that the Will was executed according to the required procedures set forth by law. The Witnesses must swear under oath that this is true in affidavits, depositions or in court.

If none of the witnesses to an attested Will can be produced to prove the Will, other extrinsic evidence (e.g. handwriting analysis) must be presented to convince the Court the Will is legitimate.

Since it is simple for an attorney to write the self-proving attestation clause in every attested Will, and so difficult and expensive to prove an attested Will otherwise, it is just basic malpractice for an attorney to ever draft a Will without this clause.

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B. Proving Holographic Wills

A holographic Will must be prove by presenting evidence (e.g. a sworn affidavit) by someone familiar with the testator's handwriting that the Will is, in fact, written in the handwriting of the testator.

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C. Proving Challenged Wills

If a Will to be proven by the procedures above is challenged on a claim that the testator never executed it in the first place (e.g. someone who was not the testator executed the Will) the burden is on the opponents of the Will to present evidence supporting the challenge.

3. Probating Lost Wills

If testators die and their Wills are lost (cannot be found) but the testamentary statements in them or its substance can be proven, a Petition for Probate of a Lost or Destroyed Will can be filed, and if the provisions of the Will can be proven that way. (CPC § 8223)

Chapter 12: Will Challenges and Interpretation

Wills presented to the Court for probate by a "petitioner" may be challenged by an "objector" for a number of reasons. If the objector claims the Will was **not executed by the testator as required by law** that goes to the "proof" of the Will as explained earlier the topic of "Proving Wills" after they have been submitted to the Court.

Surviving spouses and children may also challenge that they were **inadvertently omitted** from its terms. They are called "**pretermitted**" spouses and children.

Surviving spouses may also object that Wills of deceased spouses attempt to **illegally give away community property** of the surviving spouse.

In addition, Wills can be challenged on the grounds that the language in them is **fatally ambiguous**, that the testator **lacked testamentary capacity** at the time the Will was executed, that the Will is the result of **undue influence**, or that the Will is the result of **fraud**.

1. Challenges by Pretermitted Children

Under CPC §§ 21620 et seq. a child **born to or legally adopted** by a testator **after the testator executed** ALL testamentary instruments (Wills or revocable living Trusts) has a right to an **intestate share** of the testator's estate if those instruments **fail to provide** for the child UNLESS one of the following is true:

- The testator **deliberately did not provide a gift** for the child, and that is apparent on the face of the instrument (Will or Trust);
- The testator **had one or more children** yet **gave substantially all of the estate to the other parent of the omitted child**; OR
- The testator **intentionally provided for the child "outside of probate"** and the amount given or other extrinsic evidence shows the transfers were in lieu of a provision "inside probate".

This is **the most frequently tested issue** concerning Will challenges, and it is tested many different ways, so several examples are valuable.

> **For example:** Hal has separate property. He executes a Will that gives everything he has to his wife, Wanda. After that they have a child, Junior. Hal dies. Does Junior receive an intestate share of his estate? No, because Hal had "one or more children" (Junior is the one) and <u>he gave all of his estate to the other parent of the omitted child</u> (Wanda, Junior's mother).
>
> **For example:** Hal has separate property. He executes a Will that gives everything he has to his brother, Bob. After that he fathers a child, Junior, by Wanda (whom he may or may not have married). Hal dies. Does Junior receive an intestate share of his estate? Yes, because he was <u>born after the Will was written</u>, there is no evidence in the Will that he did NOT intend to provide for him, he did not give Junior's mother, Wanda, "substantially all of his estate", and there is no evidence he provided for Junior "outside of probate".

For example: Hal has separate property. He executes a Will that gives everything he has to his wife, Wanda, and says,

> "Except as otherwise provided in this Will, I have intentionally omitted to provide herein for any of my heirs, or persons claiming to be my heirs, living at the date of my death, whether or not known to me." [6]

After that Hal has a child, Junior. Hal dies. Junior gets nothing because Hal's Will expressly stated an intention to not provide for him.

For example: Hal has separate property. He has a child, Junior, and he is aware of it. Later he marries Wanda and executes a Will that gives Wanda his entire estate. Hal dies. Junior gets nothing because he was born before Hal executed the Will.

2. Challenges by Omitted Spouses

Under CPC §§ 21610 et seq. a spouse **married** by a testator **after the testator executed** ALL testamentary instruments (Wills or Trusts) has a right to a **share** of the testator's estate if those instruments **fail to provide** for the spouse UNLESS one of the following is true:

- The testator **deliberately did not provide a gift** for the spouse, and that is apparent on the face of the instrument (Will or Trust);
- The testator **intentionally provided for the spouse "outside of probate"** and the amount given or other extrinsic evidence shows the transfers were in lieu of a provision "inside probate"; OR
- The spouse made a **valid agreement waiving a right to a share** of the testator's estate.

The rights of pretermitted spouses should not be confused with "**dower rights**" or "**elective share rights**" that are provided in some other States. In California surviving spouses are only protected from intentional disinheritance by community property rights. Pretermitted spouses only protected from unintentional omission from the testamentary instruments of a deceased spouse.

The "share" of the testator's estate that a pretermitted spouse has a right to receive is **an intestate share** but not more than half of the deceased spouse's separate property. This would always be an intestate share UNLESS the deceased spouses were the last living descendent of their parents (e.g. there are no surviving parents, siblings or their issue.) This minor detail is **seldom tested**.

3. Challenges Requiring Election

If a testator's Will purportedly gives away property that legally belongs to someone else, the rightful owner can challenge the Will and negate the gift. BUT if the Will also gives other gifts to the challenger, and clearly expresses an intent that those other gifts are conditioned on the challenger not opposing the other gift provisions of the Will, the challenger must **elect to either challenge the Will or take the other gifts provided** and cannot both challenge the Will as to some provisions and seek to benefit from the Will as to the other provisions.

[6] This is fairly standard "boilerplate".

> **For example:** Hal owns Blackacre as his separate property and a half interest in Whiteacre as community property with his wife Wanda. If Hal dies and his Will clearly says he is giving "all of Whiteacre" to Junior, Wanda can clearly challenge that gift as to her half-interest in Whiteacre. But if Hal's Will also gives Blackacre to Wanda, and it is clear that gift is conditioned on Wanda allowing Junior have all of Whiteacre, Wanda must elect to EITHER challenge the Will and lose her right to receive Blackacre OR take Blackacre and give up her interest in Whiteacre. (*Estate of Wolfe*, 48 Cal.2d 570.)

This same principal applies to testamentary gifts of interests held in **joint tenancy**. (*Estate of Kennedy*, 135 Cal.App.3d 676.)

4. Challenging Testamentary Capacity

Every adult who has not been adjudicated by a Court of law to lack testamentary capacity is **presumed to be competent**. To rebut this presumption generally requires a presentation of evidence the testator, at the time the Will was executed, <u>substantially lacked the ability to understand what they were doing</u>. In general this means they were **suffering serious dementia** or otherwise **acting as a result of serious delusions** more than simple emotional instability.

> **For example:** Hal suffered from bi-polar syndrome for many years. He executed a Will giving his wife Wanda nothing. If she challenges the Will on the grounds that his mental impairment made him incompetent she will lose.

Lack of capacity is usually impossible to prove if testators have an attorney and can tell the attorney who they are, where they live, who their children are, who their grandchildren are, what they own, and who they want to receive their estate when the Will is executed.

If a testator is found to have lacked testamentary capacity at the time the Will was executed, **the Will is void** in its entirety.

5. Alleging Fraud

Fraud in regard to Wills is a claim that testators executed Wills that favored particular beneficiaries because they were deliberately told **false statements** about a **material fact** by someone who **knew the statements were false** with an **intent to deceive** the testator, and the testator executed the Will in reliance on the falsehood.

If fraud can be proven, the Will is NOT VOID. Rather, the beneficiaries who were favored **will receive no more than intestate shares** of the estate.

> **For example:** Tess tells her neighbor Mary she is going to give half of her estate to Mary and half to Tess' only child, Tom. Mary falsely tells Tess that Tom is a drug addict. Because of this Tess executes a Will that says, "I give everything to Mary because she told me Tom is a drug addict and Mary will take care of him." In a situation like this Tom can show the gift to Mary is the result of fraud. Mary would just receive NOTHING because she is just a "neighbor" and has no right to any intestate share of the estate. Tom would get everything (by intestate succession) as Tess' "only child".

6. Challenge for Undue Influence, Menace and Duress

Undue influence is a claim that the testator was so pressured by another person to execute the Will in dispute that it is not a true expression of their own desires at all. "**Menace**" and "**duress**" are simply the same basic claim of undue influence, but with higher levels of severity perhaps. The Will challenger who claims the Will is the product of undue influence, menace or duress usually has the burden of proof to prove this is true, and this requires convincing evidence.

As a guideline the evidence generally needs to show that the testator was being deliberately subjected to **threats**, **physical abuse** or **mental abuse** that would support a claim of **elder abuse**.

The mere fact that a testator is dependent on another person who would benefit under the provisions of a Will or that the person who is benefited urged the testator to favor them is NOT alone enough to prove undue influence. This is true even if the person who benefits under the terms of the Will **urged the testator** to give them their estate, **arranged for the Will** to be drafted, **told the attorney the provisions** to be written into the Will, and **took the testator to the attorney** to have the Will executed, <u>as long as the testator meets alone with the attorney</u> and can show <u>they know what the provisions in the Will are</u> and <u>they intend to execute the Will anyway</u>.

A substantial factor in a Court's determination whether a Will is the product of undue influence or fraud is whether or not it would benefit the "natural objects of the testator's bounty", and obvious "natural objects of the testator's bounty" are those people who take care of them, keep them company, and upon whom they have been dependent.

> **For example:** Tess was elderly and totally dependent on her neighbor Mary for her personal and medical care for several years. Mary cared for Tess without compensation, but eventually told Tess she deserved to get her estate when she died because of the loving care she had provided. Mary called Larry Lawyer and told him Tess wanted to give her everything she had when she died. Mary paid for Larry to draft the Will. Then Mary told Tess she was not going to take care of her anymore if she did not sign the Will. Mary took Tess to Larry's office. Larry then took Tess into his office alone while Mary waited in the lobby. Larry asked Tess if she understood the Will would give everything she had to Mary. Tess stated that she did understand that and she signed the Will anyway in Larry's presence. These circumstances have been found as a matter of law to NOT constitute undue influence. The pivotal fact is that Tess told Larry, outside the presence of Mary, that she knew what the Will said and that she was willing to sign it. The fact that she was elderly and wanted to reward the one person who had cared for her for "several years" is hardly surprising and suggests Mary is not the recipient of an "undue benefit".

7. Presumed Undue Influence, Menace and Duress

If a witness to a Will or closely related people receive gifts under the terms of the Will, and there are <u>not two or more other disinterested</u> witnesses, there is a presumption of **duress**, **menace**, **fraud** or **undue influence** as to those gifts. <u>This shifts the burden of proof to the beneficiary</u> to prove there was NOT duress, menace, fraud or undue influence. That is very difficult to prove. The effect of this is that the gifts that could be received by the interested witness re limited to <u>no more than an intestate share</u>. (CPC § 6112 (c), (d).)

8. Fraud Presumed if Confidant Gets Undue Benefit

However, if a person with a "**confidential relationship**" with the testator receives an **undue benefit** under the terms of a Will, the burden of proof often shifts to the recipient to prove the Will is NOT the product of undue influence.

A "confidential" relationship is **not easy to define and it is a matter of degree**. A "confidential relationship" is broader than a "fiduciary relationship". So all "fiduciary relationships" such as attorney - client, doctor - patient, guardian - ward, priest – penitent, and conservator - conservatee are automatically "confidential relationships", but some confidential relationships are not "fiduciary relationships". Family relationships (e.g. parent – child) are not "confidential relationships".

A "confidential relationship" means the beneficiary has such a close personal or professional relationship with the testator that if the testator's Will gives the beneficiary an **undue benefit** it strongly suggests there has been **undue influence**. This can create a presumption of undue influence that shifts the burden of proof.

> **For example:** Tess is dying. After trying traditional medical treatment she goes to Omar, a faith healer. After being treated intensely with herbs, prayers, colored lights, and voodoo for a month Tess changes her Will to give Omar everything and her children nothing. She dies a month later. Since Tess only knew Omar for a couple months, receiving all of Tess' estate is an **undue benefit** to him. A Court (i.e. judge) may very well find that Omar had a "confidential relationship" with Tess and the burden of proof may shift to Omar to prove that the gift he received under the Will was NOT the result of undue influence.

9. Fraud Presumed if Beneficiary Drafts Will

If a person drafts a testator's Will and they or their family or business associate is a beneficiary under its provisions there is a automatic presumption of **duress**, **menace**, **fraud** or **undue influence** as to the gifts provided in the document. The presumption is virtually conclusive, and the beneficiaries can receive no more than intestate shares. This is **strictly true for attorneys** and this is **frequently tested**.

> **For example:** Tess has attorney Al draft her Will. Tess tells Al she wants to give his wife a very small gift (e.g. some jewelry of moderate value). Undue influence will be presumed and Al's wife cannot receive more than an intestate share of Tess' estate. Virtually no evidence Al's wife could present would overcome this presumption.

10. Ambiguity: Interpretation of Terms

A Will may be challenged for ambiguity, and the Court may be asked to interpret the meaning of a Will's terms. Extrinsic evidence may be presented to prove that a document was intended to **be a Will**, and to **clarify their terms** (who the beneficiaries are and what each is to receive). The rules for interpreting the provisions of Wills and Trusts are set forth at CPC §§ 6200 et seq. and 21101 et seq. and may be called the **California Rules of Construction**".

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A. Plain Meaning Used

When interpreting Wills, the Court looks to the **plain meaning** of their provisions, and if the intent of the testator is not ambiguous (i.e. no ambiguity apparent on the face of the Will given the factual context within which the Will was drafted) **no extrinsic evidence will be allowed** to challenge the plain meaning of its terms. (CPC § 21102.)

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B. Precatory Language

In interpreting Wills (and other legal documents) particular care should be paid to the **exact terms** used and the **plain meaning** of those terms. **Precatory language** is an expression of a "hope" or "desire" that something happen as opposed to a <u>mandatory requirement</u> that it happen. Courts must interpret precatory language within the context of entire document and the factual situation in which the Will was drafted to determine if they are actual terms of the document or merely expressions of hopes and desires. Attorneys should be careful to avoid precatory language completely.

> **For example:** Tess' Will said, "Upon my death I want my estate to go to Tom, but hope Mary can stay in my house on A Street for as long as she wants. Then I would like to see that go to Bob. I want him to share it equally with Sue." A Court (judge) would have to decide whether Tess meant Tom gets everything and these other expressions are just "wishes" about how Tom might use it or if she is really trying to say, "Tom gets everything except the house on A Street. That goes to Bob and Sue in equal shares subject to a life estate to Mary."

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C. Latent Ambiguity

When a Will appears ambiguous only within the factual context it is called **latent ambiguity**. That may be because two or more people match the description of the beneficiary named in the Will, nobody exactly matches the beneficiary described in the Will, two or more assets match the gift described in the Will, or no asset exactly matches the gift stated in the Will. These are often called "**errors of description**" and **extrinsic evidence** (e.g. testimony by witnesses) can be admitted to resolve this type of ambiguity.

> **For example:** Tess' Will gave her "residence" to her "little brother" and her "cottage" to Mary. If the facts show she has an older brother who is small in stature and a younger brother who is big in stature the term "little brother" is latently ambiguous and extrinsic evidence may be admitted to show which brother she meant. Further, if she alternatively lived in two different dwellings the terms "residence" and "cottage" are latently ambiguous. Extrinsic evidence may be admitted to show which structure she referred to as her "residence" and which she meant when she said "cottage".

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D. Interpretation of Technical and Legal Terms

Technical terms are to be interpreted according to their technical meanings, and legal terms are to be interpreted according to their legal meanings.

> **For example:** Tess' Will gave her estate to her "nieces and nephews" and was drafted by an attorney. Did that just give her estate to the children of her brothers and sisters, or did she also intend for her <u>husband's nieces and nephews</u> to be beneficiaries? The plain legal meaning of the term "nieces and nephews" is the children of Tess' brothers and sisters and not the children of her brothers-in-law and sisters-in-law.

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E. Interpretation to Give Meaning to the Whole

If the intent of a Will is ambiguous an interpretation that gives every provision some effect is preferred over interpretations that make some provisions meaningless. All parts of the instrument are to be construed in relation to the others to form a consistent whole. And interpretations that avoid intestacy are preferred over those that cause the Will to fail. (CPC §§ 21120 et seq.)

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F. Fatally Ambiguous Terms

Some common phrases have been found by law to be so inherently ambiguous they are without meaning and extrinsic evidence to prove what they meant will not be allowed. Those are "personal effects" and "belongings".

> **For example:** Tess died owning a bank account with $300,000, some clothing, jewelry and furniture. Her Will gave her "personal effects and other belongings" to Bob and "the rest" to John. The term "personal effects and other belongings" is so ambiguous it is impossible to know what it means. As a result the gift to Bob will fail and John will get everything.

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G. No Extrinsic Evidence to Prove Testamentary Intent

Extrinsic evidence is NOT allowed **to prove the testator had testamentary intent**. If extrinsic evidence were allowed to prove testamentary intent it would open the door to **oral Wills** but, by law, Wills must be expressed in writing.

> **For example:** Tess tells Mary, "I am going to my attorney to execute a Will." She dies on the way. In her pocket she has a list that says, "Car – Johnny; House – Mary; Bank account – Susan." That evidence cannot be admitted to prove Tess intended to create a Will with those provisions because that would effectively make her statement to Mary an "oral Will".

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H. Errors of Omission

If a Will fails to provide gifts for anyone it is called "**errors of omission**". Extrinsic evidence is NOT allowed to prove errors of omission because that would also open the door to **oral Wills**.

> **For example:** Tess tells Mary, "I signed a Will today that will give you Blackacre when I die." She dies and her Will fails to mention any intention of giving Mary anything at all. Mary is **barred from testifying** about what Tess told her orally.

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I. No Uncertain Gifts Lacking Independent Legal Significance

If a Will provides a gift of an amount to a beneficiary that is in a certain place but otherwise <u>uncertain in value the gift fails</u> unless the thing given has "**independent legal significance**". The term "independent legal significance" means that the asset to be given is kept in the place where it is for purposes other than simply to prove a gift to the beneficiary.

> **For example:** Tess' Will says, "I give Mary my checking account at Well Fumble Bank and Tom the money I put in the envelop in my the safe deposit box there with "This is to be given to Tom when I die" written on the envelope." The gift to Mary is valid because a "checking account" has an independent legal significance. Tess is not maintaining the account simply to give Mary a gift. And since the amount in the account would naturally fluctuate, it would be impossible for Tess to say at the time she executed her Will exactly how much money would be in the account when she died. But the gift to Tom fails. He gets nothing because <u>Tess did not say how much money she put in the envelope</u>. The amount in the envelope has no independent purpose.

11. No-Contest Clauses

A **no-contest clause** is a provision in a Will that says people who challenge a Will lose all rights to receive anything under it or perhaps will receive a nominal amount like $1. They are also called "In Terrorem" clauses. They are defined and controlled by CPC §§ 21310 et seq.

No-contest clauses are intended to discourage "Will contests". Clients love these, but they are only effective against a **narrowly defined class of Will challenges** and have very, very limited effectiveness in the real world. No-contest clauses are narrowly construed. (CPC § 21312.)

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A. No Effect if Challenge Succeeds

A no-contest clause has no effect if a Will is challenged and the challenge succeeds regardless of what type of challenge is involved. (Duh.)

> **For example:** Tess executes a Will that gives her daughter Mary nothing. She challenges that the Will was the product of undue influence, and she succeeds. The Will is ruled invalid and Mary will get an intestate share.

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B. No Effect if Challenger Would Get Nothing Anyway

A no-contest clause has no effect if a Will doesn't give the challenger anything whether the challenge succeeds or not. (Duh.)

> **For example:** Tess executes a Will that gives her daughter Mary nothing. She challenges that the Will and loses. Mary is no worse off than she was before (except she will have to pay Court costs, which are a fairly minor amount).

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C. Enforced Against a Narrowly Defined Class of Challenges

A no-contest clause is only enforceable against the following types of actions:

1. An objection **without probable cause** that:
    a. The Will is a **forgery**;
    b. The Will was **not properly executed**;
    c. The testator **lacked capacity** at the time of execution;
    d. The Will is the result of **menace, duress, fraud** or **undue influence**;
    e. The Will was **revoked** by a subsequent Will or by being burned, torn, obliterated or destroyed by the testator; or
    f. A **beneficiary is disqualified** from receiving a gift under the Will because they were an **interested witness**.
2. An objection that **property to be distributed** by the Will was **not owned by the testator** at the time of death, <u>if the no-contest clause specifically provides for this application.</u>
3. A **claim filed against the estate** or prosecution of an action based on it, <u>if the no-contest clause specifically provides for this application.</u>

The term "**probable cause**" for purposes of no-contest clauses means **a reasonable person, knowing what the challenger knows, would believe the Will should be challenged** at the time the challenge is made, regardless of how the facts turn out to be later. (CPC § 21311(b).)

> **For example:** Tess executes a Will that gives her daughter Mary $10,000 and another daughter, Sue $500,000. Mary hears from a friend that Sue had her husband, Larry Lawyer, draft the Will and Tess signed it when she was seriously impaired from dementia. She challenges the Will on the grounds Tess lacked capacity, that it was the result of fraud, and that Sue exerted undue influence over Tess. Whether Mary wins or loses the no-contest clause will not prevent her from receiving her $10,000 bequest because <u>any reasonable person hearing the same facts would believe there was probable cause</u> to challenge the Will.

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D. No Effect if Challenge is about Acts of Executor

A no-contest clause has no effect if the challenge concerns the acts of an executor rather than the validity of the Will or some provision in it.

> **For example:** Tess executes a Will that names Mary as her executor and the Court appoints Mary. All other interested parties (other named beneficiaries and creditors of the estate) are fully free to challenge the appropriateness of acts done by Mary (or Mary's failure to act) in administering the estate and the amounts she should be reimbursed and compensated.

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E. Petitions for Court Interpretation are Not Will Challenges

A request for the Court to interpret the terms of a Will is a request for declaratory relief and not a challenge of the Will for purposes of enforcement of a no-contest clause.

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F. No-Contest Provisions Contrary to Statute are Ineffective

The statutory provisions for application of no-contest clauses stated above are effective notwithstanding any contrary "no-contest" provisions written into a Will. (CPC § 21314.)

Chapter 13: Trust Creation

Trusts are legal entities created by people who are called **grantors** (or "settlors") when they convey assets to people who are called **trustees** with the intention the trustees will manage and use those assets to help people called **beneficiaries** or else for the **public benefit**. The grantors, trustees and beneficiaries can all be the same people or they can be entirely different people. And the assets of the Trust are called the **Trust estate**.

> **For example:** On his death bed Grant says to Trudy, "Please run my farm for my little boy, Benny, until he is old enough to farm it." Trudy agrees. Grant dies. Grant (the **grantor**) has created a Trust for Benny (the **beneficiary**), the **Trust estate** is the farm, and Trudy is the **trustee**. The purpose of the Trust is to manage the farm to provide Benny with financial support until he can manage the Trust estate on his own.

1. Controlling Statutes

In California the creation of Trusts, their management, and litigation concerning them is primarily controlled by **common law principals** except to the extent those are modified by statute in CPC §§ 15000 et seq. (CPC § 15002.) Under CPC § 15400 California law only applies if:

1. The grantor was domiciled in California when the Trust was created;
2. The Trust was created in California (i.e. the Trust instrument was executed in California); OR
3. The Trust instrument states that California law controls.

2. Basic Trust Law

Before getting into the details of Trust creation it is useful to know basic Trust law and which rules explained above as to Wills also apply to Trusts. Little of this is frequently tested but explaining it first avoids confusion later.

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A. Common Characteristics of All Trusts

There are basic requirements of all Trusts:

1. The grantors must act with <u>intention to create</u> a Trust;
2. The Trust must <u>possess assets</u> (the <u>Trust estate</u>);
3. Trusts must have <u>one or more trustees</u> to manage the Trust estate;
4. There must be a <u>Trust agreement</u> between the grantors and the trustees; and
5. The Trust must <u>have a purpose</u> of using the Trust estate to provide benefits to <u>beneficiaries</u> or for the <u>public benefit</u>.

If a Trust has no assets or purpose for existing it automatically terminates. But if a Trust has no trustees it remains valid and the Court will appoint a new trustee to manage the Trust upon petition by an interested party.

Charitable Trusts usually have a Board of Trustees.

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B. Rules that Apply Equally to both Wills and Trusts

Many of the rules that apply to Wills apply equally to Trusts. These are **not often tested** as "Trust" issues. Rather when these issues are tested, they are usually tested as "Will" questions.

1) Interpretation of Terms

If the terms of a Trust are ambiguous they are interpreted according to the same rules as Wills are interpreted.

2) Testamentary Intent, Capacity, Undue Influence, Menace, Duress and Fraud

As is the case with the creation of Wills, grantors of a Trust must act with **testamentary capacity** and **intent to create** a Trust. If it can be proven the grantor lacked testamentary capacity the Trust is entirely void.

And as with Wills, grantors must act freely without **undue influence**, **menace, duress** or **fraud**. If it can be proven the gift provided to a beneficiary was the result of undue influence, menace, duress or fraud, the beneficiary can receive no more than an intestate share of the grantor's estate.

3) Fraud Presumed if Confidant Receives Undue Benefit

If a person with a "**confidential relationship**" to the grantor receives an **undue benefit** under the terms of the Trust fraud or undue influence may be presumed, the same as with a Will.

4) Fraud Presumed if Beneficiary Drafts Trust

If a beneficiary drafts a Trust for a grantor, undue influence, menace, duress or fraud are presumed and the beneficiary can receive no more than an intestate share of the grantor's estate the same as with a Will.

5) Pretermitted Children and Spouses

Pretermitted children and spouses can challenge Trusts on the same basis they can challenge Wills and the same rules and definitions apply. If they succeed in their challenge, **pretermitted children receive an intestate share** of the grantor's estate the same as in a Will challenge. And if **pretermitted spouses**, succeed in their challenge they receive an intestate share of the estate <u>but not more than half of the deceased spouse's separate property</u>, the same as in a Will challenge.

6) Required Elections

If a Trust states it is giving away property that does not legally belong to the grantor, the rightful owner of that property has a right to challenge the Trust and negate the gift. BUT as with Wills, if the Trust also gives other gifts to the challenger, and clearly expresses an intent that those other gifts are conditioned on the challenger not opposing the other gift provisions of the Trust, the challenger must **elect to either challenge the Trust or take the other gifts provided** and cannot both challenge the Trust as to some provisions and seek to benefit from the Trust as to the other provisions.

7) No-Contest Clauses

The same rules concerning no-contest apply to Trust challenges as for Will challenges.

8) "Notarization" Irrelevant

As with Wills, Trusts do not need to be "notarized" and having a Trust "notarized" has no substantive legal effect. Many "estate planning" attorneys do have Trust instruments "notarized", but it has almost no legal effect and is apparently done only to impress (and perhaps bill) clients who have no knowledge of the law. [7]

9) Copies Equivalent to Original

As with Wills, copies of a Trust are essentially equivalent to an original unless the Trust is challenged and then the original is more effective in proving the grantor's signature on the Trust instrument is not a forgery.

10) Integration Doctrine

The Integration Doctrine applies to Trusts the same as for Wills, but if the Trust is revocable documents incorporated by reference do not have to exist in the same form at the time the Trust is created.

> **For example:** A Trust instrument executed in 2004 refers to "attached Schedule A". Attached to the Trust instrument is a "Schedule A" but it is dated 2006. If the Trust is revocable, this is effective because a revocable Trust <u>and all documents incorporated by reference</u> can generally be modified after the Trust is created.

11) Rule Against Perpetuities

The Rule Against Perpetuities applies to <u>private</u> Trusts the same as for Wills. It does not apply to the creation of <u>charitable</u> Trusts in the same way because in that case the <u>public interest</u> generally vests as soon as the Trust is created.

12) Powers of Appointment

The rules for Powers of Appointment apply to Trusts the same as for Wills.

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[7] The only effect of having a signature acknowledged by a Notary Public is that if it is challenged as a <u>forgery</u> the standard of proof the challenger must meet is raised from "preponderance of the evidence" to "clear and convincing proof".

C. Differences between Wills and Trusts

Trust law is substantially different from Will law in a few ways.

1) No Required Writing, Witnesses or Signatures

Unlike Wills, Trusts do not have to be written. Trusts can be oral, established by a handwritten document, or established by a type-written document. Since Trusts do not have to be written, they do not have to be signed either. But if the existence of an oral Trust is challenged its existence must be proven with **clear and convincing evidence**. (CPC § 15207.)

In actual practice, living Trusts are almost always established in a signed, written document called the **Trust instrument**, but that is not actually required by California law.

When Trusts are written, no witnesses are required by California law although they usually are witnessed by someone.

2) No Presumption of Fraud if Beneficiary is Witness

Since Trusts do not have to be witnessed, there is no automatic presumption of fraud, undue influence, menace or duress if a beneficiary under the terms of a Trust also acts as a witness when the grantor signs the Trust instrument.

3) Revocable Trusts are Freely Modifiable

Revocable Trusts are modifiable in the same manner they can be revoked. As a result, "interlineation" and other modifications made without witnesses are generally effective.

4) No Automatic Revocation and Revival

Unlike Wills, if a Trust gives a gift to a spouse or domestic partner, and the union dissolves, the gifts are not automatically revoked.

3. Revocable and Irrevocable Trusts

Trusts can be classified as **revocable Trusts** or **irrevocable Trusts**.

A **revocable Trust** is simply a Trust that can be freely revoked by the grantors who created it. Grantors can generally revoke the Trusts in part or in whole, and they can recover all assets from the Trust that they have conveyed to it. Their conveyance of property to the Trust is effectively a "**conditional conveyance**" and the "condition" is that if they change their mind they can get their property back.

If a Trust is revocable, it can be modified by the grantor. (CPC § 15400.)

An irrevocable Trust is one that cannot be revoked or modified after it is created (at least not easily). The grantor's conveyance of property to the Trust is treated as an "**unconditional gift**".

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A. Capital Gain Treatment for Revocable and Irrevocable Trusts

The most important distinction between revocable and irrevocable Trusts is that the U.S. Tax Code (the Internal Revenue Code) applies to them in very different ways when it comes to capital gains. Even though this is extremely important, this is **never tested**.

For most beneficiaries revocable Trusts provide highly beneficial tax advantages. If property passes from grantors to beneficiaries through a **revocable** Trust the beneficiaries receive distributions from the Trust at the death of the grantor free from liability for capital gains.

> **For example:** Grant bought Blackacre for $100,000 and it is now worth $1,100,000. He has a capital gain of $1 million. If he sells Blackacre he will have to pay about $233,300 in taxes (15% federal and 9.8% California rates as of 2010, less interaction because State taxes are deductible on federal returns). And if he gives Blackacre to his son, Benny, and Benny sells it, he will also have to pay the same amount in taxes. But if Grant puts Blackacre into a revocable Trust that will convey it to Benny at Grant's death, Benny can sell Blackacre at that time and won't have to pay any taxes at all. That is a **tax savings** of $233,300!

In comparison, if appreciated property is conveyed to an **irrevocable** Trust the beneficiaries do NOT receive the assets free from capital gains.

> **For example:** Grant bought Blackacre for $100,000 and it is now worth $1,100,000. He has a capital gain of $1 million. If he puts Blackacre into a irrevocable Trust any later sale by anybody (by the Trust or by Benny or by any other beneficiary) is fully taxable. That is a **tax loss** of $233,300!

Conveyances to irrevocable Trusts are the same as inter vivos gifts. The recipient of the gift receives the capital gain liability that the donor had. And a sale of an appreciated asset during life simply incurs a tax liability that could easily be avoided completely.

One of the saddest (and rather frequent) statements attorneys hear is, "Grandpa knew he was dying so he 'got his affairs in order' and sold Blackacre and all his stock portfolio so us kids would be saved the trouble of doing that after he was gone."

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B. Income Tax Reporting for Revocable and Irrevocable Trusts

Revocable Trusts do not require a TIN and any income they receive is taxed as income of the grantor (on the grantor's IRS form 1040).

Irrevocable trusts must always have their own taxpayer ID number (TIN) and must pay income taxes at rather high rates on all undistributed accumulations (using IRS form 1041).

This is **never tested**.

4. Living and Testamentary Trusts

Except for Court-established Trusts, explained below, Trusts are either **living Trusts** or **testamentary Trusts**.

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A. Living Trusts

When grantors create Trusts during life they are called "**living Trusts**" or "**inter vivos Trusts**". All revocable Trusts are "living Trusts" because the fact that they are "revocable" necessarily means the grantors are still alive. And under California law all living Trusts are revocable Trusts unless otherwise specified in the Trust instrument.

The most common purposes of revocable living Trusts are:

- To avoid Probate Court at the death of the grantors;
- To avoid capital gain and estate taxes;
- To provide for the needs of a surviving spouse; and
- To provide for the needs of children who are minors, alcoholic, drug addicts, or deeply in debt.

The most common purposes of irrevocable living Trusts are:

- To create Special Needs Trusts to provide for the needs of disabled beneficiaries; or
- To create charitable Trusts to benefit the public interest by supporting religious, scientific, charitable, philanthropic, educational, ecological or similar programs.

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B. Testamentary Trusts

Trusts created in a Probate Court under the terms of a decedent's Will are called "**testamentary Trusts**". They are generally established to care for minor children or mentally retarded, alcoholic or drug-addicted adult beneficiaries. They can also be charitable Trusts established by a testator's Will. Testamentary Trusts are always irrevocable.

Testamentary Trusts do not provide beneficiaries any greater benefit than a living Trust, whether revocable or irrevocable, and they cause the beneficiaries to incur substantial and unnecessary Probate Court costs and attorney fees. Generally the trustees must file an accounting with the Court and schedule a hearing after the first year and every other year after that. This is **never taught or tested**.

In the vast majority of situations it is simply legal malpractice for any attorney to draft a Will that deliberately creates a **testamentary Trust** because it costs the client substantial sums for no benefit. When this happens it is a case of people "getting poorer" because they have an incompetent attorney.

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C. Court-Established Trusts

Trusts may also be created by a Court. **Court-established Trusts** are always irrevocable, except by the Court itself. This is seldom taught and **never tested**.

Probate Courts will order assets that descend from the probate estate of a decedent (either a testator with a Will or an intestate decedent) to minors or other beneficiaries who are legally incompetent to be placed in Trust for them. These court-established Trusts may be called testamentary Trusts and are generally subject to the same accounting requirements explained above.

Civil courts may also direct payments received by minors and incompetent or severely disabled adults in settlement of legal actions (e.g. personal injury actions, wrongful death actions, etc.) to be placed in Trust for them. These court-established Trusts are often called "**structured settlements**". In some cases they involve the establishment of a **Special Needs Trust** for a severely disabled recipient. In other cases they may involve the purchase of an annuity from an insurance company that will pay out the settlement to the beneficiary in periodic payments.

5. Charitable and Private Trusts

Living Trusts and testamentary Trusts may be either **charitable Trusts**, established for charitable purposes defined by the Internal Revenue Code, or **private Trusts**, which simply means any Trust that does not qualify to be a charitable Trust.

Charitable Trusts are usually irrevocable Trusts because that provides lucrative tax benefits to the grantors.

> **For example:** Grant creates a Trust to set aside some wetlands he owns as a nature preserve. If he does this while he is alive it is a living Trust and if he does this by the provisions of his Will at his death it is a testamentary Trust. If his gift is irrevocable he can write it off against his taxes as a charitable donation.

6. "Totten" Trusts

A "**Totten Trust**" is a type of deposit account in a financial institution held in the name of trustees for the benefit of beneficiaries. The form of the account and deposit agreement establishes the relationship between the parties, and the account balance is the entire Trust estate. (CPC § 80.) The term is often mentioned in law school but it has little importance and is **never tested**.

Chapter 14: Charitable Trusts

Private Trusts are usually discussed first in law school and **charitable Trusts** are usually discussed later in the class as something of an afterthought. But by law private Trusts are simply defined as any Trust that is not a charitable Trust. So the more logical approach is to explain what charitable Trusts are first.

Charitable Trusts are simply any Trust defined by Section 4947 (a) (1) of the Internal Revenue Code such that contributions to the Trust are "tax deductible". (CPC §16100.) That, in turn, requires the Trust to be established within the United States or its possessions exclusively for a "charitable purpose" as defined in Section 170 (c) (2) (b) of the Code. Those purposes must be:

- Religious;
- Charitable;
- Scientific;
- Literary;
- Education;
- To foster amateur sports competition; or
- To prevent cruelty to animals or children.

In addition, no part of the net earnings of the Trust can be for the benefit of any individual.

Charitable Trusts may be established to promote "government improvement" in a general sense. But if the Trust starts to be used for political lobbying and promoting political campaigns the organization will be identified by the IRS as a "political organization" and lose its tax status as a "charitable organization". If that happens it no longer qualifies to be a "charitable Trust" under California law and becomes a "non-charitable Trust".

It may also be said that a charitable Trust is one "without an ascertainable beneficiary" but that idea can be misleading. A charitable Trust can designate an identified beneficiary IF the beneficiary is a charitable organization and NOT an individual.

> **For example:** Grant creates a Trust to support "Central Valley Little League, Inc.", which is itself a charitable, non-profit corporation. This is a charitable Trust even though the beneficiary is identified because it is a charitable organization and not an individual.

Split-interest Trusts are Trusts for some purposes that are charitable and some purposes that are not. (Section 4947 (a) (2) of the Internal Revenue Code; CPC § 16100.)

1. Supervision by Attorney General

Charitable Trusts must be registered with and subject to supervision by the California Attorney General.

2. Special and General Purpose Charitable Trusts

The **most tested issue** concerning charitable Trusts is whether the Trust is for a **special purpose** or for a **general purpose**.

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A. Specific Purpose Charitable Trusts

A **specific purpose charitable Trust** is one established for a **specific purpose** so if that purpose becomes impossible to accomplish or meaningless the Trust terminates. In that case the remaining Trust assets are distributed to alternative beneficiaries as provided in the Trust agreement or otherwise to the grantor or the estate of the grantor.

> **For example:** Grant creates a Trust for the **specific purpose** of providing aid for "needy students of Cross College". Cross College later ceases to exist and the Trust has $1 million in assets. The Trust terminates and $1 million returns to Grant or to his estate.

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B. General Purpose Charitable Trusts and Cy Pres Doctrine

A **general purpose charitable Trust** is one established for a **general purpose** so the assets can be redirected by the trustees to alternative purposes within the scope of the general purpose for which the Trust was created.

Further, even if the Trust instrument cites a specific application for the funds <u>a Court can reform the Trust</u> to redirect Trust assets to alternative purposes <u>on a finding the grantor created the Trust for general charitable purposes</u>. This is a common law doctrine called the **Cy Pres Doctrine** (pronounced "sigh-pray"). As a result, a general purpose Trust does not terminate, and the assets do not revert to the grantor or the grantor's estate.

> **For example:** Grant establishes a Trust for the **general purpose** of providing aid for "needy college students of Cross College". Cross College later combines with Holy Names College and is renamed Holy Cross. Since the Trust was for the **general purpose** of providing student aid the change in the name of Cross College does not render the Trust meaningless. If necessary, a Court can reform the Trust to reflect the change in names.

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C. Extrinsic Evidence to Determine Trust Purpose

Whether a charitable Trust is for a specific or general purpose is often a hotly contested issue. Upon petition a Court may decide the issue based on extrinsic evidence showing the original intent of the Grantor.

> **For example:** Grant creates a Trust to provide aid for "needy students of Cross College". Cross College later closes down and the Trust has $1 million in assets. Grant's heirs want the money. But a nearby college, Holy Names may argue Grant's real purpose was simply to help college students in the same general area so they should get the money to help their

students. The Court would look for extrinsic evidence showing whether Grant's purpose was to benefit needy students in the general area or only those at Cross College. That might depend on whether Grant was a graduate of Cross College or if he had some other special relationship to that particular school.

3. Duties of Trustees of Charitable Trusts

The trustees of charitable Trusts have the same **duties of loyalty** and **due care** as trustees of private Trusts. That is explained in detail in the next Chapter.

In addition, the California Probate Code requires them to distribute income in a manner that will not subject the property to tax under federal law, and to not engage in self-dealing, retain excess business holdings, make taxable expenditures or invest in manners that would subject property of the Trust to taxes. (CPC §§ 16101, 16102.) Specific additional duties for trustees of charitable Trusts are set forth in the "**Uniform Supervision of Trustees for Charitable Purposes Act"** (California Government Code §§ 12580 et seq.) This is **never tested**.

4. Using Charitable Trusts for Tax Avoidance

Charitable lead Trusts, **charitable remainder Trusts** and **pooled income funds** are types of Trusts used to avoid Estate and Gift Taxes. These may be mentioned in law school classes but they are **never tested** on the California Bar Exam.

These types of Trusts must meet the requirements of sections 170(f)(2)(B) and 2055(e)(2) or section 2522(c)(2) of the Internal Revenue Code.

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A. Charitable Lead Trusts

A **charitable lead Trust** is an irrevocable Trust that first pays a certain annual percentage to a charitable purpose for a specified number of years and after that the remaining Trust estate is distributed to the grantor or other beneficiaries.

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B. Charitable Remainder Trusts

A **charitable remainder Trust** is an irrevocable Trust that is almost the reverse of a charitable lead Trust. It typically pays the grantor (and the grantor's spouse perhaps) a set percentage of income from the Trust for life and the remainder is then distributed to a charity. Various permutations of this general idea are called **charitable pooled income funds, charitable remainder annuity Trusts,** and **charitable remainder unitrusts**.

Chapter 15: Private Trusts

Private Trusts are those for non-charitable purposes. They almost always have identifiable beneficiaries that are individuals that have (or will come to have) "vested interests". There is an exception, a "non-charitable" Trust without clearly ascertainable beneficiaries. Those will be explained at the end of this Chapter.

The rules for naming beneficiaries for private Trusts are the same as for Wills – beneficiaries may be specifically named (e.g. "John Doe") or described with sufficient certainty (e.g. "my children") that they can be identified. In either case they have or will come to have "vested interests". That means they will have legal rights to receive Trust benefits.

The **most frequently tested** issues with respect to private Trusts are whether the trustees have breached their duties.

1. Trust Beneficiaries

The beneficiaries of a Trust can be either **present** or **future** beneficiaries.

> **For example:** Grant creates a iving Trust that says he (Grant) is the sole beneficiary and trustee for the rest of his life and upon his death the Trust estate is to be go to his son, Benny. Grant is the **present beneficiary** and Benny is the **future beneficiary**.

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A. Life, Income and Principal Beneficiaries

A Trust can provide for the support of beneficiaries during their life and they are often called "**life beneficiaries**". When life beneficiaries die the residual of the Trust estate is often distributed to **future beneficiaries** who are often called "**principal beneficiaries**".

A Trust may provide that life beneficiaries can only receive the income earned by the Trust estate and cannot invade the principal. In that case the life beneficiary is often called an "**income beneficiary**".

Future beneficiaries who receive distribution from the Trust estate after life or income beneficiaries have died or upon the failure of stated conditions of the Trust agreement may also be called **resulting beneficiaries**.

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B. Honorary Trusts

Under California law the beneficiaries of a private Trust can either be people or animals. If an animal is the beneficiary of a Trust it is called an "**honorary Trust**". (CPC § 15212.)

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C. Beneficiary Vesting

Trust beneficiaries are "vested" if they have a present legal right to receive Trust benefits, whether the right is to receive the benefits at the current time or at some future time.

> **For example:** Benny, 12 years old, is a named beneficiary of a Trust that says he will have a right to receive money from the Trust when he reaches the age of 21. If the Trust becomes irrevocable he becomes a vested beneficiary at that time because he will have a present legal right to receive money in the future.

The grantors of revocable living Trusts are always vested in the Trusts as long as they are alive because they have present legal rights to revoke the Trusts and recover their assets. If a third party has agreed to act as trustee, the trustee's duty is to do whatever the grantors ask of them. A possible exception would be if the grantors lose legal capacity. In that event the Trust would become irrevocable until the grantors regain capacity.

The beneficiaries of revocable Trusts (other than the grantors) are not vested and have no legal rights. Trustees owe them no duties if their interests in the Trust are revocable. Their interests may be called "**mere expectancies**".

When revocable Trusts is irrevocable the rights of the beneficiaries vest and the trustees become obligated to act prudently to benefit all of the beneficiaries, both life beneficiaries and principal beneficiaries.

> **For example:** Grant creates a revocable living Trust that says he (Grant) is the sole beneficiary for life and after his death the Trust estate will be distributed to Priscilla. Grant is a life beneficiary and Priscilla is the principal beneficiary. Grant names Trudy to be the trustee. Grant is vested in the Trust estate because it is a revocable Trust. Trudy owes Grant a duty because Grant is a vested beneficiary. Pricilla is not vested because Grant can revoke the Trust at any time. Pricilla has no legal right to demand or receive anything as long as the Trust is revocable. She merely has an "expectancy". If Grant tells Trudy to invest foolishly, Trudy has a duty to do what Grant asks, and he has no duty to protect Priscilla. But if Grant falls into a coma he cannot revoke the Trust and it becomes irrevocable until he recovers capacity. Then Pricilla is "vested subject to total divestment" and Trudy has a duty to act prudently to protect the interests of both Grant and Priscilla. If Grant subsequently dies Trudy's duty is to distribute the remaining Trust estate to Priscilla. If Grant recovers Priscilla is divested and her interest reverts to an "expectancy".

2. Trust Purposes

A private Trust automatically terminates if it no longer has any purpose for existing. The purpose of a private Trust is always to benefit the beneficiaries in the manner the grantors intended for them to be benefited.

If a Trust terminates the Trust estate is distributed according to the provisions stated in the Trust agreement. If the Trust agreement does not provide for distribution at termination the Trust estate returns to the grantors or to their estates if they are deceased.

> **For example:** Grant's Trust says he (Grant) is the sole beneficiary for life and after his death the Trust estate will be distributed to his son Benny. If Benny dies before Grant the Trust still has a purpose, to provide for Grant. But when Grant dies the Trust will no longer have any purpose and will terminate. At that point the Trust estate to return to Grant's estate unless an alternative plan of distribution is provided for in the Trust agreement.

3. Creditors' Ability to Reach Private Trust Assets

A recurring question regarding Trusts is the rights of creditors of the grantors and/or the beneficiaries to reach the Trust estate. That means their ability to either seize the assets of the Trust estate by legal process, to place liens on them or else to garnish distributions to the beneficiaries. "Garnishing" means legally seizing a portion of a distribution.

This issue is **occasionally tested** but often taught in a piece-meal fashion that produces unnecessary confusion. It is simpler to just approach the issue head-on.

Two overriding factors are whether the Trusts are self-settled or funded with fraudulent transfers. Beyond that it depends on whether the Trust is revocable or not, and if it is an irrevocable Trust it depends on the terms of the Trust instrument.

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A. Self-Settled Trusts

The creditors of <u>beneficiaries</u> can always reach the assets in the Trust estate if the Trust is self-settled. A **self-settled Trust** is one that <u>exists because of a beneficiary's own acts or failure to act</u>. This is just common sense. People with debts simply cannot avoid paying them by putting their assets into a Trust for their own benefit.

> **For example:** Grant creates a Trust to benefit himself. Since the Trust exists because Grant created it, it is a self-settled Trust.

If a beneficiary has the <u>legal right to take</u> assets of the Trust estate it will be treated the same as a self-settled Trust.

> **For example:** Tom creates a Trust to benefit Dick and Harry equally. Dick is the trustee, and he has absolute discretion to distribute the Trust estate to himself and/or Harry at any time he wants. The Trust will be <u>treated as if it was self-settled by Dick as to his own interest</u> because he has the right to distribute his own share to himself. But the Trust will <u>not be treated as self-settled as to Harry's interest</u> because Harry has no power to force Dick to distribute his portion.

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B. Trusts Funded with Fraudulent Transfers

The creditors of grantors can always reach assets conveyed into the Trust estate by **fraudulent transfers**.

Under the Uniform Fraudulent Transfer Act (California Civil Code sections 3439, et seq.) a fraudulent transfer is one made for less than fair market value by a debtor who is insolvent or otherwise intended to hinder, delay or defraud creditors or knowing or reasonably expecting it will have that effect.

Creditors can void fraudulent transfers or otherwise reach the assets to recover debts owed.

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C. Revocable Trusts

Revocable Trusts are always self-settled Trusts of the grantors because they only exist because the grantor created them and has not acted to revoke them.

Therefore, the creditors of grantors can ALWAYS REACH the assets of any revocable Trust they created. This remains true even if the grantors have died and the Trust has become irrevocable because of their death. (CPC § 18200.)

And the creditors of beneficiaries can NEVER REACH the assets of revocable Trusts as long as the Trust remains revocable by the grantors because the beneficiaries are not vested and have no legal right to receive anything from revocable Trusts. Of course this is not true if the Trust is self-settled by the beneficiaries in some manner.

Consequently, **transfers of assets into revocable Trusts are NEVER FRAUDLENT**. (*Gagan v. Gouyd* (1999) 73 Cal.App.4th 835, 844.)

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D. Irrevocable Trusts

The creditors of grantors of irrevocable Trusts can ALWAYS REACH the assets if the Trusts are self-settled or fraudulently funded, or if they were revocable Trusts that have become irrevocable because of the death of the grantor. (CPC § 18200.)

The creditors of beneficiaries can ALWAYS REACH assets after they have been distributed from the Trust to the beneficiaries.

The issue that is **frequently tested** is whether or not creditors of a beneficiary can reach the assets of an irrevocable Trust established for the beneficiaries by a third party (e.g. the beneficiary's parents).

Creditors can ALWAYS reach the undistributed assets of irrevocable Trusts UNLESS they are **spendthrift Trusts, support and education Trusts**, or **discretionary Trusts** AND the debts to be recovered are NOT for:

- **Child support** payments,
- **Spousal support** payments,
- **Felony restitution** payments,
- **Public assistance** payments, OR
- Otherwise **excessive amounts are being held in trust** and **attachment is required by equity**.

  For example: Benny is the beneficiary of an irrevocable Trust created for him by his father, Grant. If it is not a spendthrift Trust, a support and education Trust or a discretionary Trust, Benny's creditors can always reach the Trust estate. If it is one of those types of Trusts, the creditors can still reach the assets to recover child support, spousal support, felony restitution payments or public assistance payments. Otherwise the creditors can only reach the assets if the Trust is holding excessive amounts and justice demands attachment of the Trust assets.

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E. Spendthrift Trusts

A **spendthrift Trust** is one that by its own express provisions states the Trust estate **cannot be assigned, anticipated or seized by legal process**. Usually the Trust instrument states something like the following:

> "The Trust estate cannot be assigned, anticipated or seized by legal process".

This means that the beneficiaries cannot sell or give away their legal rights to receive Trust benefits, cannot borrow against those rights, and creditors of the beneficiaries cannot reach Trust assets. (CPC §§ 15300 et seq.)

The assets of spendthrift Trusts can never be reached as long as they are revocable by the grantor. If they are irrevocable the assets can only be reached (e.g. garnished, seized by legal process) by creditors of the beneficiaries to recover child support, spousal support, felony restitution payments, public assistance payments or excessive amounts are held in trust and equity demands attachment. (CPC §§ 15305 et seq.)

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F. Support and Education Trusts

A **support and education Trust** is one that by its own express provisions limits the trustee to providing only for the reasonably necessary expenses required to support and educate the beneficiaries. (CPC § 15302.) Usually the Trust instrument states something like the following:

> "The trustee shall use the Trust estate to provide for the reasonably necessary support and education of the beneficiaries."

Generally the trustee of a support Trust cannot pay for luxuries for the beneficiaries.

The assets of support Trusts can never be reached as long as they are revocable by the grantor. If they are irrevocable the assets can only be reached (e.g. garnished, seized by legal process) by creditors of the beneficiaries to recover child support, spousal support, felony restitution payments, public assistance payments or excessive amounts are held in trust and equity demands attachment. (CPC §§ 15305 et seq.)

Support and education Trusts often also have a “spendthrift clause” so they are “support and education, spendthrift Trusts”.

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G. Discretionary Trusts

A **discretionary Trust** is one that by its own express provisions gives the trustee **absolute discretion whether or not to distribute** Trust assets to the named beneficiaries. (CPC § 15303.)

A discretionary Trust effectively gives the trustee a **discretionary special power of appointment** over the portion of the Trust estate in question.

The assets of discretionary Trusts can never be reached as long as they are revocable by the grantor. If they are irrevocable the assets can only be reached (e.g. garnished, seized by legal process) by creditors of the beneficiaries to recover child support, spousal support, felony restitution payments, public assistance payments or excessive amounts are held in trust and equity demands attachment. (CPC §§ 15305 et seq.)

Discretionary Trusts often also have a “spendthrift clause” so they are “discretionary spendthrift Trusts”. <u>Discretionary Trusts are never support and education Trusts</u> because trustees of support and education Trusts have an <u>affirmative duty to act</u> while trustees of discretionary trusts have no duty to act at all.

> **For example:** Grant creates a revocable Trust to benefit Benny and appoints Tom to be the trustee. The Trust instrument indicates the Trust is a discretionary spendthrift Trust. While Grant is alive he can always revoke the Trust. Therefore creditors of Benny cannot reach the assets. If Grant dies the Trust becomes irrevocable and Benny’s creditors can only reach the assets if they are seeking recovery of **child support, spousal support, felony restitution payments, public assistance payments** or if the assets in the Trust **exceed Benny’s needs** and attachment is necessary to prevent injustice.

4. Compensation of Trustees

Trustees have a right to be reimbursed for all expenses of Trust administration and to be paid compensation as set forth in the Trust instrument. Otherwise, if the Trust instrument does not define trustee compensation, trustees have a right to be paid **reasonable compensation**. (CPC § 15680.) This is very important in the real world but seldom taught and **never tested**.

Generally attorneys acting as trustees cannot pay themselves for legal services rendered to the Trust, and trustees cannot pay any of their relatives, law partners, relatives of law partners, or their employers for legal services. (CPC § 15687.)

5. Duties of Trustees

If grantors of revocable Trusts are trustees of those same Trusts, which is often the case, they have no duty to do anything for anybody and no liability to anyone. This is **never tested**.

> **For example:** Grant creates a revocable living Trust to benefit Benny. Grant assumes the role of trustee. He does a terrible job, takes Trust assets and eventually loses all of the Trust's money. Grant did not breach a duty to the Trust or to Benny and he is not liable because it was a revocable Trust and he was the grantor.

If the trustees of revocable Trusts are not the grantors of those same Trusts their only duty is to do whatever the grantors tell them in writing to do (assuming the grantors are competent). (CPC § 16001.) This is also **never tested**.

> **For example:** Grant creates a revocable living Trust to benefit Benny. Grant appoints Tom to be the trustee. Grant tells Tom in writing to take some money from the Trust, to invest in General Motors and Tom does what he is told. Eventually the Trust loses all of its money. Tom did not breach his duty to the Trust or to Benny and he is not liable because it was a revocable Trust and he did what Grant, the grantor, told him to do.

The trustees of irrevocable Trusts, as soon as they accept the position of trustee, have clear duties to both the Trust and to the beneficiaries. The Trusts may have been created as irrevocable or else they may have become irrevocable because the grantors died or became incompetent. The duty of the trustees is to administer the Trust according to the provisions of the Trust instrument and unless the Trust instrument provides otherwise, according to the California Probate Code. (CPC §§ 16000 et seq.)

> **For example:** Grant creates a revocable living Trust to benefit Benny, appoints Tom to be the trustee, and then dies or becomes incompetent. The trust has become irrevocable (unless Grant regains capacity). Tom has a duty to administer the Trust according to the provisions of the Trust instrument. He generally also has a duty to pay for Grant's funeral expenses, pay Grant's taxes and debts, manage and invest the remaining Trust estate wisely, provide for Grant if he is alive, provide for Benny if Grant is dead, inform Benny about the Trust, its assets and Benny's rights under the Trust provisions, and to never take or use any Trust assets for his own benefit.

This is one of the **most frequently tested** areas of Trust law. Therefore, the rest of the explanation about "trustee's duties" in this Chapter concerns <u>irrevocable Trusts</u>.

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A. Trustee's Duty to Pay Grantor's Expenses

The assets of a <u>revocable</u> Trust that has become irrevocable due to the death or incapacity of the grantor are subject to the claims of the grantor's creditors and the trustee has a duty to pay the unsecured debts of the grantor, taxes, funeral expenses and expenses of estate and trust administration out of the Trust estate. (CPC §§ 19000 et seq.) This is very important in the "real world" of probate law but **never tested**.

A possible exception to this is that the proceeds from qualified retirement accounts such as IRAs, 401(k) plans, etc. that transfer to a deceased grantor's Trust or estate at the death of the grantor are subject to rather complicated rules that may shield them from all liability. In that case the trustee has a duty to NOT use them to pay the grantor's expenses. This is **never tested**.

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B. Trustee's Duty of Loyalty

The trustees of an irrevocable Trust owe the Trusts a fiduciary **duty of loyalty**. This is **heavily tested**.

1) Duty of Impartiality

If a Trust has two or more beneficiaries the trustee has a duty to treat them impartially and to act impartially in investing and managing Trust assets given the differing interests of the beneficiaries. (CPC § 16003.) This is simply a duty of loyalty to each beneficiary, given the relative interests of each beneficiary and the purpose of the Trust.

> **For example:** Tom is the trustee of an irrevocable Trust with two beneficiaries, Lucy and Benny. The Trust provisions say its main purpose is to support Lucy by giving her all of the Trust income for the rest of her life. At her death the remainder of the Trust estate will go to Benny, who is not as needy as Lucy. Tom has a duty to invest the Trust assets in a manner that it will provide adequate income to Lucy. But he cannot act in a way that would give her excessive amounts to Benny's detriment. He has a duty to balance the needs and interests of both beneficiaries in an impartial manner.

2) Ban on Self-Dealing with Trust Assets

Trustees have a duty to NOT "**self-deal**" with Trust assets. This means a duty to not use or take any Trust assets for their own use or for the use of family members and friends. Likewise, trustees cannot use Trust assets in transactions in which they or their family or friends have a financial interest. (CPC § 16004.)

If a trustee self-deals with Trust assets they are presumed, by law, to have violated their fiduciary duty. (CPC § 16004.) The burden is on the trustee to prove that the acts taken were not in breach of fiduciary duty. This is substantially different from the role of an attorney-in-fact. If an attorney-in-fact self-deals with property of the principal it may constitute a breach of fiduciary duty, but the burden of proof is on the principal to prove that.

> **For example:** Tom is the trustee of an irrevocable Trust holding land. Tom's sister Betty wants to buy the land. Tom has the land appraised and sells it to his sister for the fair market value. Tom has engaged in self-dealing and it will be legally presumed he has breached his duty to the Trust because he has sold Trust assets to a member of his family. The fact that Betty paid fair market value is only relevant to the extent it may be introduced as evidence challenging the legal presumption.

3) Ban on Enforcement of Claims

Trustees cannot enforce any claims against Trust property that they purchased after or in contemplation of being appointed to be trustee. However, a court may allow them to be reimbursed for amounts they paid in good faith for the claims. (CPC § 16004.)

4) Duty to Avoid Conflicting Trustee Roles

A trustee has a duty to avoid knowingly becoming a trustee of a second Trust with conflicting interests, and to eliminate the conflicts or resign. (CPC § 16005.)

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C. Trustee's Duty of Due Care and the Prudent Investor Rule

Under CPC §§ 16006 et seq. trustees have a duty to **use due care** to:

- **Preserve** and **manage** Trust property;
- To **make Trust property it productive**;
- To **identify** and **separate** Trust property from other property (i.e. to not commingle assets);
- To **enforce claims** of the Trust against others
- To **defend the Trust** in legal actions that may cause losses;
- To **act personally and not delegate or transfer trustee duties** to others; and
- To use due care in **selecting and supervising agents**.

1) Standard of Care

The trustee has a duty to act with reasonable skill, care and caution as a prudent person would use in the same circumstance. (CPC § 16040 et seq.)

2) Prudent Investor Rule

Under the **Uniform Prudent Investor Act** (CPC §§ 16045 et seq.) a trustee must invest and manage Trust assets as a prudent investor would, given the purposes, terms, distribution requirements, and other circumstances of the Trust.

This often means the trustee should **invest Trust assets in a broadly diversified portfolio**. A broadly diversified portfolio generally is one with <u>no more than 5% invested in any one asset</u>.

> **For example:** Grant creates a revocable living Trust to benefit Benny. Grant appoints himself to be trustee and Tom to be successor trustee. Grant invests all of the Trust assets in General Motors stock. This is not a breach of Grant's duty as trustee because he is the grantor of the Trust and it is a revocable Trust. But if Grant dies and Tom assumes the role of trustee, Tom has a fiduciary duty to <u>immediately</u> sell the bulk of the General Motors stock (at least 95% of it) and reinvest the proceeds in a highly diversified portfolio of different investments!

The duty to diversity and the prudence of investing some or all Trust assets in one or a few assets depends on the circumstances.

> **For example:** Grant creates a revocable living Trust to benefit Benny. Grant appoints himself to be trustee and Tom to be successor trustee. Grant states that the purpose of the Trust is to provide a place for Benny to live, and the only asset of the Trust is the house where Benny lives. If Grant dies and Tom assumes the role of trustee, Tom has a fiduciary duty to NOT sell the house where Benny lives. Rather his duty is to maintain the house so Benny can continue to live in it <u>because that is what Grant wanted</u>.

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D. Trustee's Duty to Inform Beneficiaries

The trustee of an irrevocable Trust has a duty to keep the beneficiaries reasonably informed of the Trust, its terms and its administration. (CPC § 16060.) This is **often tested**.

1) Statutory Notice Requirement

When a Trust becomes irrevocable a trustee has a legal obligation to provide notice to all beneficiaries of the Trust, all heirs at law of the deceased grantors (if their death is the event that causes the Trust to become irrevocable), and to the California Attorney General if the Trust is a charitable Trust. (CPC § 16061.7.) This fact is **never tested**.

If trustees give proper notice as required by CPC § 16061.7 the people given notice cannot challenge the validity of the Trust after the passage of 120 days. (CPC § 16061.8.)

If trustees fail to give the notice required by CPC § 16061.7 they are liable for all damages and attorney fees that failure causes those who were to be given notice. (CPC § 16061.9.)

> **For example:** Grant creates a revocable living Trust to benefit his son Benny. Later Grant has a daughter, Alice. Grant dies and Tom assumes the role of trustee. Tom distributes all of the assets of the Trust to Benny without informing Alice of the existence of the Trust or that Grant has died. When Alice discovers Grant has died and the terms of the Trust she challenges that she is a pretermitted child. She is not barred by CPC § 16061.8 because she was not given the notice required by CPC § 16061.7. The court agrees with Alice and grants her an intestate share of Grant's estate. But by then Benny has spent all the money. Tom is liable to Alice under CPC § 16061.9 because he did not give required notice.

2) Duty to Provide Accounting

Trustees have a duty to provide an accounting of Trust assets, income and expenditures to beneficiaries. That duty may be modified by the terms of the Trust instrument.

3) Duty to Inform Beneficiaries of Trust Rights

Trustees have a duty to reasonably inform beneficiaries about their rights to receive benefits under the Trust instrument. This is **occasionally tested**.

For example: Tom and Dick live together in Tom's house. Tom creates a Trust that says when he dies his house is to be given to his son Benny, if Benny wants the house. Otherwise the house is to go to Dick. Grant names Harry to be the trustee. Tom dies. Harry has a duty as the trustee to tell Benny he has a right to receive the house, so that Benny can decide if he will take it or not. If Harry never informs Benny of his rights and just lets Dick continue to live in the house, he has breached his duty to Benny and to the Trust.

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E. Trustee's Duty to Properly Allocate Assets

If some Trust beneficiaries are **income beneficiaries** for life or as long as some condition holds and others are **principal beneficiaries** who will receive the balance of the Trust estate when the life beneficiaries are no longer eligible to receive Trust benefits, the trustees have a duty to properly allocate receipts and expenditures between the **income accounts** and the **principal accounts** so that each beneficiary gets the proper amount. This is **often tested**.

Generally Trust income is <u>interest, rents, profits</u> and <u>cash dividends</u>. These should be <u>added</u> to the **income account**. And <u>on-going expenses</u> such as property taxes, utilities, bank fees and routine maintenance should be <u>deducted</u> from the **income account**.

Trust receipts from <u>sales of assets</u>, <u>stock splits</u>, <u>stock dividends</u>, and other "<u>distributions</u>" from assets should be credited to the **principal account**.

If a Trust owns residential dwellings, those are principal assets. Proceeds from the sale of any dwellings should be allocated to the principal account, but rents received from tenants should be credited to the income account.

Ranching poses an unusual situation. If a Trust owns 100 cows they are principal assets of the Trust. Receipts from the sale of cows should be credited to the principal account. But the purpose of ranching is to produce offspring to be sold. So if the cows have calves, receipts from the sale of the calves should be credited to the income account. This is **never tested**.

1) Accounting for Interest

Trustee accounting for interest is **seldom tested** because interest on bank accounts is stated on the monthly statements and so simple everyone understands it while calculating interest on other assets like bonds is so complicated law students are never expected to understand it. So either way it is not worth testing.

2) Accounting for Dividends

Trustee accounting for dividends is **often tested**. Whether a dividend should be allocated to the income account or the principal account depends on whether it is a "**cash dividend**" or a "**stock dividend**".

The vast majority of "dividends" are "cash dividends" and the term "dividend" implies a cash dividend. If a dividend is NOT a cash dividend it will be called a "stock dividend". Other corporate distributions like "warrants" and "purchase rights" are treated the same as stock dividends but those are never tested and you should not worry about them.

Whether corporations distribute dividends or not is up to Boards of Directors. If a Board decides to distribute a dividend, it will announce that and state a **record date**. The shareholders who hold stock in the corporation at the close of trading on the record date are the ones who will receive the dividends. The record date may be before or after the date of the announcement. If a dividend is declared without citing a record date the date of declaration is the record date. Prices for stocks traded after dividend record dates are said to be "ex-dividend". The Board of Directors will also announce a **distribution date** when the dividends will be distributed. The distribution date will always be after the record date (Duh!).

Cash dividends are simply checks sent by a corporation to each shareholder. They are calculated on a "per share" basis. The term "dividend" implies a "cash dividend". So if a dividend of $1 is announced, on the distribution date the corporation will send every shareholder $1 for every share they held at the close of trading on the record date.

Stock dividends are shares of stock credited to the accounts of shareholders. They are also calculated on a "per share" basis. So if a dividend of 1/10th share is announced, on the distribution date the corporation will credit every shareholder with an additional 1 share of stock for every 10 shares they held at the close of trading on the record date. Typically only whole shares of stock are issued and "fractional shares" are ignored.

Whether corporations distribute dividends or not is up to their Boards of Directors. If a Board announces a dividend it will state a **record date**. Shareholders holding stock at the close of trading on the record date will receive the dividends. The record date may be before or after the date of the announcement. The Board of Directors will also announce a **distribution date** when the dividends will be distributed.

> **For example:** Acme corporation declares a cash dividend of $1 per share and a stock dividend of 1/10th of a share on June 8th, to be distributed on July 1 to the shareholders of record on June 1. The **record date** is June 1 and the **distribution date** is July 1. Suppose a Trust owned 100 shares of Acme on June 1 but the trustee sold the stock on June 2. The Trust will still receive the dividend because it held Acme shares at the close of trading on the record date, June 1. The fact that the stock was sold after that date is irrelevant. On July 1 the Trust will issue 10 shares of Acme stock (1/10 X 100 shares) in the name of the Trust and send the trustee a check for $100 ($1 X 100 shares).

3) Allocating Delayed Receipts between Income and Principal

If a Will or Trust designates "income" is to be given to an **income beneficiary** and "principal" to a **principal beneficiary**, amounts received by the estate or Trust must be allocated between those two accounts. This is more often taught and tested within the context of Trust **income beneficiaries** and the **accounting duties of trustees**. That is why it is being explained in more detail here instead of earlier within the context of Wills. Both situations are equally controlled by CPC § 16340.

The right of an income beneficiary to receive Trust income becomes vested as specified in the Trust instrument or otherwise when the gift becomes irrevocable. This point in time may be called the "**income date**" but it avoids confusion to call it the "**income start date**". A revocable Trust becomes irrevocable on the date the grantor dies and the rights of income beneficiaries become vested on and after that day absent some other Trust provision.

Amounts received by a trustee on or after the **income start date** are allocated as follows.

- If payment received was DUE to be received BEFORE the income start date it is to be allocated to PRINCIPAL (to be reserved for the future distribution to the principal beneficiary) even if it is actually received after the income start date.

  For example: Grant created a revocable Trust naming Benny the income beneficiary and Pricilla the principal beneficiary. Grant (as trustee) sells a Trust asset to Sam in exchange for $10,000. Sam's check arrives in the mail after Grant has died. Since the Trust was due to receive all the money before Benny had a vested right to receive Trust income the $10,000 is <u>principal</u> and not income.

  For example: Grant created a revocable Trust naming Benny the income beneficiary and Pricilla the principal beneficiary. Grant's Trust owns Acme stock. Acme declares a dividend to all shareholders of record on June 1. Grant dies on June 5 before he receives the dividend check. Since the Trust was due to receive the dividend before Benny had a vested right to receive any Trust income the dividend is <u>principal</u> and not income.

- If a PERIODIC payment is received after the income start date it must be PRO-RATED so the portion ACCRUED before the income start date is allocated to PRINCIPAL and the balance to INCOME.

  For example: Grant created a revocable Trust naming Benny as the income beneficiary and Pricilla the principal beneficiary. Sam is renting a Trust asset for $1,000 a month and he pays his rent at the end of each month. Grant dies in the middle of the month and Sam pay his rent at the end of the month. Since the Trust was due to receive half the rent before Grant died, that half is <u>principal</u> and the other half is <u>income</u>.

- Receipts from <u>income-producing property</u> that are NOT PERIODIC and received BEFORE the income start date are PRINCIPAL and those received ON OR AFTER the income start date are INCOME.

  For example: Grant created a revocable Trust naming Benny as the income beneficiary. The Trust owns a heard of cattle. Milk taken from the cows before Grant dies are <u>principal</u>, and milk taken on or after the day he dies are <u>income</u>.

The right of an income beneficiary to receive Trust income terminates as specified in the Trust instrument or otherwise when the income beneficiary dies. This point in time might be called the "**income end date**". [8]

Amounts received by a trustee on or after the **income end date** are allocated in the same way. If the income beneficiary was due to receive the payments before the income end date the payments are <u>income</u> (to be paid to the deceased income beneficiary's estate). Otherwise they are <u>principal</u> (to be paid to the principal beneficiary).

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[8] I had a professor who used "income date" to mean both the start date and the end date – very confusing.

Receipts by estates after testators die are treated the same. For example, if Tess' Will says Benny gets her sow and Roy gets the residual, those rights vest on the day Tess dies. If the sow gives birth to 3 piglets just before midnight before the day Tess dies and 4 after midnight of that same day, Roy Roy gets the first 3 piglets and Benny gets the sow and the last 4 piglets born on that day Tess died. This is **never tested** in a Wills context.

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F. Liability of Trustee

Trustees owe their fiduciary duties to the beneficiaries and are civilly liable to them for a breach of those duties. The remedies of beneficiaries against trustees are exclusively in equity (CPC § 16421.) There are several exceptions to this but they are **seldom if ever tested**.

1) No Liability for Acting as Directed by Grantors in Writing

Trustees of <u>revocable</u> Trusts have no liability if they act as directed by the grantors in writing (or by anyone else authorized to revoke the Trust). (CPC § 16462.)

2) No Liability if Acts Fair and Reasonable with Fully Informed Consent

Trustees have no liability to any beneficiary for acts or omissions committed with that beneficiary's fully informed consent at or before that time if the beneficiary had capacitated at the time as long as the transaction involved was fair and reasonable as to the beneficiary. (CPC § 16463.)

3) No Liability for Acts of Agents, Co-Trustees and Previous Trustees

Under CPC §§ 16400 et seq. trustees have no liability for the wrongful acts of their agents, co-trustees or previous trustees UNLESS:

- They directed, approved, participated, acquiesced to, negligently enabled or concealed the wrongful acts;
- They negligently selected agents or failed to periodically review their agent's activities;
- They failed to take reasonable steps to prevent or correct their wrongful actions after they knew or should have known of them; or
- They improperly delegated Trust administration or non-delegable duties;

4) Three Year Limit on Trustee Liability

Actions against trustees for breach of duty claims that are not otherwise barred must be brought within three (3) years after beneficiaries, or their legal representatives, receive written accountings or other reports adequately disclosing the breaches or otherwise after the breaches were or should have been discovered. (CPC § 16460.)

The Trust agreement can limit actions against trustees to a shorter period, but not less than 180 days. (CPC § 16461.)

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G. Indemnification of Trustee by Beneficiaries

Under CPC § 16461 the provisions of a Trust agreement can indemnify trustees from liability for their acts UNLESS they:

- **Deliberately breached** their duty;
- Acted with **gross negligence**;
- Acted with **reckless indifference**; or
- For any **profits they have gained** from self-dealing with Trust assets.

Under CPC § 16463 beneficiaries who consent to acts by trustees indemnify them from liability UNLESS:

- The beneficiaries **lacked capacity** at the time of consent;
- The beneficiaries **consented without knowledge** of their legal rights or other material facts that the trustee was aware of and did not reasonably believe the beneficiaries knew;
- The beneficiaries **consented because of improper acts** by the trustee; or
- The trustee **had a financial interest** in a transaction that was **not fair and reasonable** to the beneficiaries.

6. Revocation of Private Trusts

Trust revocation is **seldom tested**. The basic rule is that under CPC § 15401 a revocable private Trust can be partially or completely revoked EITHER:

- By the procedures **stated in the Trust instrument** OR
- By delivering a **written revocation statement signed by the grantor** (settlor) to the trustee.

The "written revocation" necessary to revoke a Trust cannot be a Will because Wills have no legal effect until the death of the testator and can always be revoked prior to that.

Gifts from one spouse to another or between domestic partners in Trusts are subject to **automatic revocation** if the union is dissolved , and to **automatic revival** if the union is reestablished the same as with Wills.

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A. Revocation by One of Multiple Grantors

If a revocable Trust is created by two or more grantors it can be revoked by any one of them alone as to that revoking grantor's **separate property** interest in the Trust estate unless the Trust instrument provides otherwise. (CPC § 15401.)

> **For example:** Hal and his wife Wanda buy a home and the Deed transfers it "to Hal and Wanda as joint tenants". Even though they acquire the home during marriage, the title form establishes that it is not community property. Instead it is jointly held separate

property interests. [9] They create a revocable Trust and convey their home into it. Later each of them has the right to revoke the Trust as to their own separate property interest, but they cannot revoke the Trust as to the interest of the other spouse!

If a husband and wife convey **community property** into a revocable Trust it remains community property unless the transfer instrument (e.g. Deed) or the Trust instrument or some other express written transmutation agreement expressly provides otherwise. Either spouse alone can revoke the Trust as to ALL community property unless the Trust instrument provides otherwise. (California Family Code § 761.) [10]

> **For example:** Hal and his wife Wanda buy a home and the Deed transfers it "to Hal and Wanda as community property". This establishes that the property is community property for all purposes. They create a revocable Trust and convey their home into it. Later each of them has the right to revoke the Trust as to the entire community property interest, but the house remains community property afterward.

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B. Revocation by Attorney-in-Fact

A Trust cannot be revoked by a grantor's attorney-in-fact (i.e. an agent granted Power of Attorney by a grantor) unless the Trust instrument expressly provides for that. (CPC § 15401.)

7. Modification and Termination of Trusts

Both revocable and irrevocable Trusts can be modified and terminated as set forth in the Trust instrument. In addition they may be modified and terminated as set forth in the Probate Code.

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A. Modification and Termination of Revocable Trusts

The modification and termination of revocable Trusts is very important but often untaught and **seldom tested**.

1) Total Revocation is Equivalent to Termination

The termination of a revocable Trust is simply a complete revocation as explained above.

2) Power to Revoke Gives Power to Modify

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[9] This is a part of the *Lucas* decision that was never reversed by legislation. But the legislature did establish that for purposes of division in dissolution jointly held property will be treated as community property in most cases. Otherwise it is treated as jointly held separate property. See **Nailing the Bar's Simple California Community Property Outline**.

[10] For property to be community property the Deed must state it is held "as community property" or else a separate express written transmutation statement must be signed by the spouses agreeing the property is "community property". Again, see **Nailing the Bar's Simple California Community Property Outline**.

If a Trust can be revoked in whole or part by a grantor it can be modified by the grantor as to that same interest by the same revocation procedures. (CPC § 15402.). Often Trust instruments require modification to be based on joint consent.

3) Automatic Revocation and Revival of Trusts

As stated earlier, Trusts are subject to automatic revocation and revival the same as Wills when they provide for a gift to the grantor's spouse who is later divorced or if the grantor remarries the former spouse. And the same rules apply to domestic partners.

4) Modification as to Community Property Requires Consent

If a revocable Trust is created by a married couple with **community property** the Trust cannot be modified in any way that changes the rights and interest of the spouses in that property during the marriage without the consent of both spouses unless the Trust instrument specifically provides otherwise. (California Family Code § 761(a).) This is **never tested**.

5) Equitable Estoppel of Revocation by Surviving Grantor

If a revocable Trust is created by two or more grantors each can revoke the Trust as to their separate property but this may create an injustice which may be **equitably estopped** on a claim of **detrimental reliance**. This is important to know but **seldom if ever tested**.

> **For example:** Hal and Wanda put $2 million of jointly owned property in a Trust that will give half of their combined property to Hal's son from a prior marriage, Al, and the other half to Wanda's daughter from a prior marriage, Betty, when the last of them dies. After Wanda dies Hal modifies the Trust to give all his property ($1 million) to Al. The Trust is irrevocable as to Wanda's interest. Consequently Al would get $1.5 million at Hal's death and Betty would only get $500,000. This is not what Wanda was promised by Hal. Betty could **equitably estop** Hal's changes because Wanda **detrimentally relied** on his assurance Betty would get half of the combined property.

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B. Modification and Termination of Irrevocable Trusts

Irrevocable private Trusts may be modified or terminated by the Court upon petition by beneficiaries alone, or by beneficiaries in cooperation with grantors. The power of the Court to do this is called the **Cy Pre Doctrine**, but that term is more generally used with respect to charitable Trusts than private Trusts. This is **occasionally tested**.

1) Modification and Termination by All Beneficiaries

The Court can generally modify or terminate an irrevocable private Trust upon petition from ALL beneficiaries (without participation of the grantor) on a finding that **the need for modification or termination OUTWEIGHS the need to accomplish the remaining material purposes** of the Trust. However, the Court is barred from terminating Trusts that are subject to valid restraints on transfer of beneficiaries' interests (e.g. it is a spendthrift or support and education Trust.). (CPC § 15403.)

For example: Grant created a spendthrift Trust to provide income to Benny for life and the principal is to be distributed to Grant's "heirs" after that. When Grant died the Trust became irrevocable. Benny and all Grant's descendants petition the Court to terminate the Trust and convey the remaining Trust estate to Grant's children because Benny does not need the income from the Trust and Grant's children do need the money. However, the Court cannot do this in this situation because Grant created a **spendthrift Trust** and the Trust instrument says Benny's interest is not subject to voluntary or involuntary transfer. But for that the Court could have terminated the Trust.

2) Modification and Termination by Some Beneficiaries AND Grantor

The Court can modify or terminate an irrevocable private Trust upon petition from SOME beneficiaries AND the grantor on a finding that **the modification or termination DOES NOT SUBSTANTIALLY IMPAIR the interests of objecting beneficiaries** of the Trust. (CPC § 15404.) Further, if the Trust instrument provides for distribution to the grantor's "heirs" the Court can limit the class of individuals whose consent is needed to only those who are "likely to take".

For example: Grant created an irrevocable Special Needs Trust to provide income to Benny for life and the principal is to be returned to Grant if he is alive at that time or to his "heirs" otherwise. Benny, Grant and all Grant's children petition the Court to terminate the Trust and convey the remaining Trust estate back to Grant. But Grant's grandson, Opie, refuses to consent to termination. The Court can terminate the Trust if it finds it would not substantially impair Opie's interest, or it can limit the class of "heirs" who need to consent to Grant's children rather than considering the interests of his grandchildren.

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C. Termination under the Merger Doctrine

Under the common law **Merger Doctrine** Trusts automatically terminate if there is only **one beneficiary**, and that beneficiary is also the **sole trustee**. However, in California the Merger Doctrine does not apply if a grantor is also a sole trustee and sole beneficiary. (CPC § 15209.)

For example: Grant's Trust makes him the sole beneficiary for life and then the Trust will support his friend Benny for life. Nobody is named to be a beneficiary after that. Tom and Benny are the co-trustees. After Grant dies the Trust continues to exist for the purpose of supporting Benny, and Benny is not the sole trustee. But then Tom dies and Benny is both the sole beneficiary and sole trustee. Under the **Merger Doctrine** the Trust will automatically terminate. The Trust estate will return to Grant's estate. If Benny is not a beneficiary of Grant's Will he will take nothing. He is not an intestate heir of Grant because he is just a "friend".

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D. Termination for Lack of Purpose

Trusts automatically terminate if they lack any legal purpose. That can occur if the Trust estate is depleted of assets or the beneficiaries are all dead.

For example: Grant establishes a Trust to support Benny for life. If Benny dies or the Trust runs out of money it no longer has any purpose for existing and will automatically terminate.

8. Trusts are Private and Take Immediate Legal Effect

Private Trusts are private matters but if they relate to real property they can be recorded with the County Recorder in the County where it is located. (CPC § 15210.) If that is done they become public documents. That should only be done if parties other than the grantors have vested legal interests in the Trust document's provisions (e.g. the beneficiaries have agreed to give consideration in exchange for being named beneficiaries). Otherwise they do not need to be recorded and generally should not be. This is important to know but **seldom if ever tested**.

For example: Grandma has equity in her home but cannot afford her mortgage payments. So Sonny agrees to pay her mortgage payments for the rest of her life if Grandma, in exchange, will give Sonny her house via a revocable Trust at her death. Since the Trust is revocable, Sonny will enjoy significant tax benefits – he receives the house free of all capital gain liability at Grandma's death. But Grandma could revoke the Trust at any time, so Sonny's interest is at risk. To protect Sonny's interest the Trust instrument requires Grandma to repay him all payments he has made for her, with interest, before she can revoke the Trust, and she cannot modify it without his consent. That gives Sonny a claim against the house and the Trust document must be recorded to protect that interest from subsequent claims against the property.

A grantor can create multiple private Trusts to maintain privacy, and the association between the grantor and the Trusts can be concealed. Sometimes these are called "**blind trusts**" or "**land trusts**". This is entirely legal as long as the purpose is not to perpetrate a fraud.

For example: Disney wants to accumulate real estate in Florida to build "Disney World" but does not want the property owners in the area to realize what is happening so they won't increase their demanded prices. So Disney hires the law firm of Dewey, Cheatum and Howe. They buy one farm in the name of "Williams Family Trust" with Dewey the trustee, another in the name of "Jane Doe Trust" with Cheatum the trustee, and a third in the name of "Mary Roe Trust" with Howe the trustee. The trusts all have different names and different trustees (with the property tax bills sent to different addresses) so it is not easy to see that a single entity is accumulating all the land in the area. After Disney has bought the land it needs it announces it is building Disney World.

Private Trusts have immediate legal existence and effect as soon as assets are conveyed to them.

Private Trust instruments do not need to be presented to the Courts when grantors die. But if the validity of a Trust or the acts of trustees are challenged the Trust instrument will have to be presented to the Court. That makes the Trust instrument a public document unless the Court is petitioned to keep the document sealed for the purpose of privacy.

For example: Brando executes a Will that disinherits some of his children. Tabloids have a field day when Brando dies because the Will has to be made public to be probated. If Brando had used a Trust, he could have shafted them with total privacy and avoid huge and unnecessary legal expenses at the same time. Did Brando get really bad legal advice? Or was he making a personal statement?

9. Private Trusts as Estate Planning Tool

Private Trusts have two essential purposes. The first is to provide for the care and support of beneficiaries (e.g. surviving spouses and minor or disabled children). The second is as an estate planning tool to avoid probate, avoid estate taxes, and avoid capital gains taxes.

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A. Avoiding Probate

The vast majority of revocable Trusts are established to avoid probate expenses. Assets conveyed to a Trust no longer belong to the **probate estate** of the grantor, regardless of whether they are in a revocable or irrevocable Trust. As a result, they are distributed to beneficiaries according to the terms of the Trust, not through the probate process. This is the most important reason clients want to have a Trust but it is **never tested**.

For married couples avoiding probate is usually not an issue at the death of the first spouse because the surviving spouse often inherits all of the estate of the deceased spouse.

> **For example:** Hal and Wanda own their house in joint tenancy. Hal dies. Wanda inherits Hal's interest in the house outside of probate. She would not be any better off if they had established a revocable living Trust.

But having a Trust becomes a major benefit when the surviving spouse dies.

> **For example:** Wanda is a widow. She owns her house outright after the death of her husband, Hal. At her death she wants her house to go to her children, Sonny and Sue. If she conveys the house into a revocable living Trust her children will receive title to the house at her death without incurring probate expenses. But other wise Sonny and Sue will incur substantial, and totally unnecessary probate expenses at Wanda's death. And this is true whether Wanda executes a Will or dies intestate.

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B. Avoiding Estate Taxes

A revocable Trust will allow wealthy married clients to avoid substantial amounts of estate taxes. This is entirely legal. It is important to distinguish between the terms "tax avoidance" and "tax evasion". Tax evasion is a crime. Tax avoidance is just common sense.

To understand how Trusts help avoid estate taxes it is important to know that all assets of a deceased spouse that pass at death to the surviving spouse are exempt from estate taxes. This is called the "**Marital Deduction**".

Assets that do not pass to the surviving spouse are subject to estate taxes, but a credit called a "**Unified Credit**" is allowed against those taxes, and it is sufficient to shelter \$3.5 million of the

taxable estate of the deceased spouse. [11] Generally those taxes must be calculated and paid within 6 months after the death of the deceased spouse.

> **For example:** Hal has a personal taxable estate of $7 million. He is married to Wanda and his Will gives Wanda his entire estate. Wanda's Will gives her entire estate to Sonny. At Hal's death Wanda receives the $7 million tax-free because of the **marital deduction**. But at Wanda's death only $3.5 of her $7 million estate goes to Sonny tax-free (because of the **unified credit**). The rest is taxed at 45% so estate taxes of $1.575 million must be paid. Sonny gets a net amount of $5.425 million.

1) A-B Trusts

Trusts avoid estate taxes by providing for the estate of the first spouse to die (the "**deceased spouse**") to be divided into two parts, A and B. The first part is put into a <u>revocable Trust</u> for the other spouse (the "**surviving spouse**") and the second part is put into an <u>irrevocable Trust</u> that will provide for the surviving spouse during life and then pass to other beneficiaries. Typically the surviving spouse is the trustee of both resulting trusts. This is **occasionally tested** in law school but not on Bar exams.

> **For example:** Hal has a personal taxable estate of $7 million. His Trust provides that at his death his wife Wanda will receive half of his estate ($3.5 million) in a revocable Trust (Trust A) over which she has complete control. The other half of Hal's estate ($3.5 million) will be put in an irrevocable Trust (Trust B). Wanda will receive the income from Trust B but the principal will be given to Sonny at Wanda's death. Wanda receives the $3.5 million in Trust A tax-free because of the **marital deduction**. And Trust B receives the rest of Hal's estate tax free because of the **unified credit**. Later when Wanda dies the amount in Trust A ($3.5 million) will pass to Sonny tax-free because a **second unified credit** will be applied. Sonny gets a net amount of $7 million, avoiding taxes of $1.575 million.

The two resulting Trusts are called many different things by attorneys:

- **Trust A** and **Trust B** (a so-called "A-B Trust");
- **Marital Deduction Trust** and **Bypass Trust**; or perhaps,
- **Survivor's Trust** and **Unified Credit Trust**.

No matter what these are called they all do the same thing. The part that goes to the surviving spouse as a revocable Trust passes tax-free because of the **marital deduction**. However, the surviving spouse must have <u>total control</u> over that part. If the Trust provisions prevent the surviving spouse from having total control over the "Trust A" portion of the deceased spouse's estate it will not qualify for the marital deduction at all.

The part of the deceased spouse's estate that passes to an irrevocable Trust (Trust B) must NOT be under the total control of the surviving spouse. If it is, it will be counted as part of the estate of the surviving spouse at the second death. However, the surviving spouse can be given all of the income of the irrevocable Trust. And in addition the surviving spouse is allowed to invade the

[11] Under 2009 rules. For purposes of the Gift tax the unified credit is only sufficient to shelter $1 million.

principal of the irrevocable Trust if it is necessary to maintain the surviving spouse's standard of living.

It is very important that the Trust instrument prohibits the surviving spouse from invading the assets of the irrevocable Trust (Trust B) unless it is absolutely necessary. If the surviving spouse is allowed (by the Trust instrument) to use assets of Trust B without limitation it will be counted as part of their own estate at their subsequent death. That would nullify all of the benefits of this strategy. If the irrevocable Trust (Trust B) is over-funded the amounts in excess of the unified credit must be paid soon after the deceased spouse dies.

> **For example:** Hal's Trust provided that at his death his widow, Wanda, would receive half of his $7 million estate in a revocable Trust (Trust A) over which she would have complete control, and the remaining $3.5 million of his estate went into irrevocable Trust (Trust B). Wanda was given the right to receive all income of Trust B and the power to invade the principal of Trust B without limitation. Wanda got the $3.5 million in Trust A tax-free because of the **marital deduction**, and Trust B got the rest of Hal's estate tax free because of the **unified credit**. But later when Wanda dies the amount in Trust A ($3.5 million) will NOT pass to Sonny tax-free because the IRS would deem it to be part of Wanda's estate since she had unlimited use of the principal.

Generally the irrevocable Trust (Trust B) is never funded with more than the amount that qualifies for the unified credit because that would just frustrate the whole purpose of having an A-B Trust. If the estate of the surviving spouse exceeds the unified credit they may be able to reduce their estates later.

> **For example:** Hal's Trust provided that at his death an amount equal to the unified credit would be put into irrevocable Trust B ($3.5 million) and the rest of his estate would be put into revocable Trust A for his widow Wanda. So when Hal dies everything he has passes tax-free one way or the other. If Wanda's estate (including the assets of Trust A) exceed the unified credit she may spend it down or give it away in small gifts to the point that at her death her estate is tax-free. Wanda may even marry a second husband, and thereby be able to execute a new A-B Trust that opens the door to yet more tax avoidance. And if Wanda ends up without enough money to live on she is still allowed to invade the principal of Trust B anyway to the extent it is necessary to maintain her standard of living.

2) QTIP Trusts

A "**QTIP Trust**" is a Trust named for the acronym "Qualified Terminable Interest Trust". It is an irrevocable Trust created at the death of a deceased spouse to provide income for a surviving spouse during life and at the death of the surviving spouse the principal is to be distributed to principal beneficiaries. This is always taught in law school but **never tested**.

The difference between a QTIP and the "irrevocable Trust B" in an A-B Trust is that the surviving spouse has no right to invade principal at all, assets in the QTIP are not subject to estate taxes until the surviving spouse dies, and the surviving spouse has no control over the assets in the QTIP Trust.

QTIP Trusts are often established for the express purpose of providing income for surviving spouses without giving them any control at all over the assets so that the principal (less estate taxes) is certain to go to the children of the deceased spouse (e.g. from a prior marriage) when the surviving spouse dies.

QTIP Trust provisions must be carefully written to meet the legal requirements.

> **For example:** Wanda is Hal's second wife. He has a son, Sonny, from his prior marriage, and Wanda hates Sonny. Wanda has a daughter from a prior marriage, Mary. Hal wants to provide for Wanda until she dies, and then he wants his estate to go to Sonny. If he leaves all of his estate to Wanda she will give it all to Mary. If he establishes an A-B Trust Wanda may give everything in Trust A to Mary (after all she has total control over that) and then invade the principal of Trust B to live on. Then Sonny will still get nothing. So Hal creates a QTIP Trust that will provide Wanda income for life but prevent her from invading the principal. When Wanda dies the QTIP Trust has assets of $7 million. At that time Hal's **unified credit** would pass $3.5 million of his estate to Sonny tax-free and the remaining $3.5 million would be subject to estate taxes of $1.575 million, giving Sonny a total inheritance of $5.425 million

3) A-B-C Trusts

Sometimes a Trust provides for both an A-B Trust division AND a QTIP Trust provision. These may be called A-B-C Trusts.

4) Gift Taxes and Gifting Plans

Under the U.S. Tax Code a person has a right to give a gift of up to $13,000 (under 2009 law) each calendar year to as many different recipients as they like without incurring Gift Tax problems. This can be used to avoid more estate taxes than Trusts alone. This is **never tested**.

However, if gifts (to any person or entity, including charities) exceed $13,000, the excess over that amount must be reported to the IRS, and the "**unified credit for Gift Tax purposes**" is reduced by that amount, and that loses all the tax advantages of the gifting plan.

Also, the unified credit for Gift Tax purposes is only enough to shelter $1 million of the taxable estate, not the $3.5 million that is sheltered for Estate Tax purposes.

As a practical matter, gifting plans are only effective when there are a lot of recipients and there are a number of years over which the plan can be implemented.

> **For example:** Donald has a personal taxable estate of $8 million. He creates an A-B Trust that puts $3.5 million in an irrevocable Trust that will support his widow, Daisy, and then distribute the principal to his three sons, Huey, Louie and Dewey. The rest of his estate ($4.5 million) is put into a revocable Trust for Daisy. This distribution is entirely tax-free because of the marital deduction and unified credit. But it leaves Daisy with $4.5 million, $1 million more than the unified credit will shelter at Daisy's death. Daisy could establish a gifting plan to give Huey, Louie and Dewey each $13,000 a year, but it would take her over 26 years to give away $1 million that way. It would be a lot more effective if Huey, Louie and Dewey each have 3 children of their own. Then Daisy could give each of those a gift also, tripling the amount she can give away each year. Then she could give the $1 million away in just 6 years.

5) Crummey Trusts

If gifts are given in Trust for minors they qualify as "gifts" for purposes of reducing taxable estates even though the minors have no direct control over the amounts they receive because they are considered to be present gifts of a future interest under the provisions of the U.S. Tax Code and the California Uniform Transfers to Minors Act (CPC §§ 3900 et seq.)

But if gifts are given in Trust for adults they are not considered to be "gifts" unless the recipients have immediate and unlimited access to the funds given. This posed a problem for donors who wanted to make gifts for estate planning purposes to young adults who were not trusted to use the gifted assets wisely. That problem was solved with the invention of the **Crummey Trust**. [12] This is frequently taught in law school but it is **never tested**.

Under a Crummey Trust approach gifts are conveyed into a Trust established to benefit young adults with the proviso that the beneficiaries have the unrestricted right to withdraw the funds for a fixed period of time (e.g. 30 days). If the funds are not withdrawn by the beneficiaries within that time frame they cannot be withdrawn at all. Typically they must be used by the trustees for support and education after that until the beneficiary reaches a certain age.

> **For example:** Daisy has a taxable estate that exceeds the unified credit that would otherwise shelter at estate at her death. She wants to give $13,000 each year to each of her children, Huey, Louie and Dewey to reduce her taxable estate. But they are only 18 years old (triplets) and she wants them to use the money for education, not partying. So she puts $13,000 into a Trust for each of them each year with the provision that they can take the money out if they want for the first 30 days and if they do not the money she (as trustee of the Trusts) will only use the money for their support and education until they reach the age of 25. Of course if any of them take the money out immediately, as they have every right to do, she has warned them she will never given them another cent, as she also has a right to do. This makes the "gifts" deductible from Daisy's taxable estate without reducing the unified credit that would apply at her death.

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C. Avoiding Capital Gain Taxes

Capital gains and how to avoid taxes on them is one of **the most important considerations** in the entire field of estate planning yet it is almost never taught in law school and **never tested**. If it is taught in law school at all, it is in classes on "taxation" and not in classes on Wills and Trusts. Yet it is inherent in everything involved in proper estate planning.

Under the U.S. Tax Code and the California Revenue and Taxation Code the recipient of an appreciated asset given by a donor "in life" has the same "basis" for calculating capital gains as the donor had at the time of the gift. But a recipient that receives an appreciated asset because of the death of the donor receives the gift with a "**stepped-up basis**". That means the recipient can immediately sell the asset without any tax liability.

[12] Named after the Crummey family. They challenged the IRS on this issue and won, establishing this as a legitimate, proven estate planning approach.

For example: Mom and Dad bought the farm for $10,000 in 1950. Mom is now 80 years old and the farm is worth $1 million. If she gives the farm to Sonny and he sells it he will have to pay almost $235,000 in taxes that could have easily been avoided (the federal capital gains rate is capped at 15% but this would push Sonny into the top California rate of 9.8%). If Sonny inherits the farm when Mom dies (through a Trust, by a Will or by intestate succession) he can sell it and pay no taxes at all. So, waiting for Mom to die and passing the farm through a Trust is a super idea.

Exceptions to the General Rule. There are some exceptional situations when it is not important to avoid gifts during life:

- Property that is **not appreciated**. Gifts of money don't present capital gains tax issues.
- **Residences recipients live in**. If a recipient has lived in a residence for at least 2 of the prior 5 years before it is sold, they get a $250,000 capital gains tax exclusion upon sale of the residence under both federal and California law. That is often enough to eliminate capital gain problems.
- Property that is **never going to be sold**. If recipients are never going to sell property they are never going to incur capital gain liabilities anyway.

10. Non-Charitable Trusts

It is often said that private Trusts must have ascertainable beneficiaries but there is an exception. A **non-charitable Trust** is one that has no specifically identified beneficiaries but is not organized for a "charitable purpose" as that is defined by the Internal Revenue Code. Since it is not a charitable Trust it is actually a private Trust. This is never taught and **never tested**.

An example of a "non-charitable Trust" is a Trust organized to promote legislation or political campaigns. It has no ascertainable beneficiary but does not qualify to be a "charitable Trust" either.

Non-charitable Trusts are governed by the same rules as private Trusts except that they cannot exist for more than 21 years. (CPC § 15211.)

Chapter 16: Special Needs Trusts

A "**Special Needs Trust**" is a generic term for a type of private Trust that is set up to care for disabled beneficiaries who are dependent on government assistance for medical care and/or food, shelter and clothing. Typically that means they receive Medi-Cal (Medicaid outside of California) and/or SSI. Special Needs Trusts must be created so the beneficiaries will not lose those benefits even though the beneficiaries derive some benefit from the Trust. This is extremely important to a lot of people but **never tested**.

Special Needs Trusts are not "charitable Trusts", even though they are to benefit a needy person, because they are established to benefit a particular individual.

There are two basic types of Special Needs Trusts, those that are funded with assets belonging to the beneficiary and those that are funded with assets belonging to some other grantor like a parent or grandparent.

In either case the Trust instrument must have provisions that:

1. The <u>beneficiary cannot be the trustee</u>;
2. The trustees <u>cannot use the Trust estate to pay for goods or services that government programs would otherwise pay</u> for (i.e. medical care, food, shelter or clothing); and
3. The trustees <u>cannot let the beneficiaries possess assets above the level</u> that would cause them to lose their government benefits (i.e. over $2,000 in liquid assets for an entire calendar month).

Special Needs Trusts Funded with Assets of Others: If a Special Needs Trust is funded by <u>assets that do not belong to the beneficiary</u> the Trust <u>can be revocable</u>, and if the Trust terminates the remaining assets can be <u>returned to the grantor or to other beneficiaries</u>. No amounts in the Trust have to be paid to the Medi-Cal program (Medicaid in other States) in this situation.

Special Needs Trusts Funded with Assets of Beneficiary: If a Special Needs Trust is funded with <u>assets of the beneficiary</u> the Trust <u>must be irrevocable</u> and there are two alternative types under Title 42 U.S. Code section 1396p (d) (4). These are called "Type A" and "Type C" trusts depending on whether they are set up under 42 U.S.C. § 1396p (d) (4) subparagraph (A) or subparagraph (C).

A "**Type A**" Trust is one set up by a parent, grandparent, legal guardian or the Court for beneficiaries who are <u>disabled and under the age of 65</u> using the <u>disabled individual's own assets</u>. The person who creates the Trust can be the trustee. When the beneficiary dies the Medi-Cal program (or Medicaid programs in other States where the beneficiary might live) has a right to recover all of its costs from the remaining assets in the Trust. Any amounts left over are distributed to alternative beneficiaries of the Trust or else they become part of the deceased beneficiary's probate estate.

> **For example:** Benny, 4 years old, is a quadriplegic after a bakery truck runs over him. His parents sue the bakery company on his behalf and receive a settlement of $4 million (less attorney fees, of course). Benny's medical care costs $250,000 a year and he has a life expectancy of 20 years (given his condition). So they establish a Special Needs Trust for Benny that will pay for all of the things Medi-Cal (Medicaid) and SSI will not, such as a

special van equipped with a wheel-chair lift. The money in the Trust is Benny's money because he was the plaintiff in the suit. So this is a Type A, section 1396p Trust. When Benny dies any money left over goes to reimburse Medi-Cal. SSI does not seek reimbursement. If anything is left after that it goes to the parents or anyone they designated in the terms of the Trust to receive the excess.

A "**Type C**" Trust is one established and managed by a non-profit corporation to maintain separate accounts for beneficiaries of any age who are disabled using the disabled individual's own assets. Accounts within the Trust can be established by anyone. It can be a parent, grandparent or legal guardian of the beneficiary, by the Court or even by the beneficiaries themselves. When the beneficiary dies the non-profit corporation has the right to retain all remaining amounts, and generally it would. But if the non-profit corporation does not retain the residue in the account it must pay the Medi-Cal program (or Medicaid programs in other States where the beneficiary might live) all of its costs from the remaining assets in the Trust account.

For example: Benny, 84 years old, is unable to care for himself and has no close family. Benny goes to the Veterans of Pointless War old-soldier's home and puts all of his assets in a VPW Trust account. In exchange the VPW Trust provides him with care for the rest of his life for the things that Medicare, Medi-Cal and the Veteran's Administration do not fund (e.g. supervised trips, telephone, cable TV, etc.) When Benny dies the VPW either retains excess amounts in the account to fund its operations or else it will have to reimburse Medi-Cal for all of its costs in providing Benny with medical care. Any excess could then go to Benny's heirs or assigns.

Special Needs Trusts must be drafted carefully in order to meet the needs of federal rules.

Chapter 17: The Dangers of Joint Tenancy

The only "estate planning" some people need is simply to put property into a "joint tenancy" form of ownership. Not everyone needs a Will, Trust, etc. And for married couples holding title as "community property" instead of as "joint tenants" is often an even better strategy. That is explained in the next Chapter.

But conveying property into joint tenancy between two or more unmarried people poses dangers and for some people it is disastrous. So it is important for you to understand how differing circumstances affect different clients. As important as this is, it is seldom taught well in law school and **never tested**.

1. Giving Away Title and Control

When clients convert assets to "joint title" with other people they are effectively **giving away** part of their property, and they don't always realize that. If you are their attorney, it is your duty to explain it to them before they do something they really don't want to do.

> **For example:** Don wants to avoid probate so he files a Deed with the county recorder that deeds his home from himself alone to himself and his daughter, Debbie, as joint tenants. This gives Debbie half of Don's interest in the house. After this Debbie can sell or give her half of the house to a stranger, borrow against her half of the house, or have a judgment lien filed against her half of the house. The judgment creditor can execute a sheriff's sale against Debbie's half-ownership, and Don can do nothing about any of this. If Debbie is bi-polar, drug addicted, etc. Don can find himself in a house with a crazy daughter (and her Hell's Angels friends) and <u>he cannot evict her</u> or make her chums leave "her" house. His only possible solution at that point is try to get a restraining order against her (on a claim of elder abuse perhaps) so he can get her out of the house <u>that he gave her</u>.

When clients put other parties on their financial accounts as co-owners they are also **giving away control** over those accounts and possibly will lose everything they have.

> **For example:** Don wants to avoid probate so he adds his daughter, Debbie, to his bank account as a co-owner. If Don dies Debbie automatically takes ownership of the account and probate is avoided. But if Debbie has a drug habit she can take all of Don's life savings and there is nothing he can do about it. And he can't "take her name off" the account either. His only remedy is to withdraw all of the remaining funds, if any, before Debbie spends it all.

In contrast to the problems illustrated above, clients can simply establish revocable Trusts and avoid probate without giving up title or losing control over the same assets.

2. Financial Dangers in Transferring to Joint Tenancy

Transferring assets to joint tenancy incurs three other potential financial problems besides just losing title and control.

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A. Unnecessary Capital Gain Taxes

If an appreciated asset is transferred into joint tenancy the recipient incurs a potential capital gain tax liability that could have been entirely avoided with a revocable Trust. The recipient of a joint tenancy interest obtains the same "basis" for calculating capital gains as the donor had.

> **For example:** Don bought a house for $30,000. That is his "basis". He conveys the house to himself and his daughter Debbie in joint tenancy. That gives Debbie half of the house and half of the "basis". So Debbie's basis for her half of the house is $15,000.

If a joint tenant dies the surviving joint tenants receive a "stepped-up" basis on the interests they receive, but the basis on their original ownership interests are not changed.

> **For example:** Don and Debbie are joint tenants. Each owns half the house and each has a "basis" of $15,000 on their individual interests. Don dies when the house is worth $300,000. Debbie inherits Don's interest with a "stepped-up" basis equal to half of the market value, $150,000. Her combined basis is now $165,000.

If surviving joint tenants sell their interests for more than their "basis" they are liable for capital gains taxes. Incurring large capital gains generally pushes clients into the top tax rates which are 15% for federal taxes and 9.8% for California taxes. The raw combined rate is 24.8%, but State taxes are deductible from income for federal purposes, so the combined rate is actually 23.3% after interactions are taken into account.

> **For example:** Don and Debbie were joint tenants and Don died, leaving Debbie with a combined basis of $165,000. If she sells the house for $300,000 she has a capital gain of $145,000 and her net tax liability on that gain will be $33,829 (at 23.33%) That tax liability would have been avoided if Debbie had inherited the house from Don through a revocable trust.

Personal Residence Exception. Under federal and California tax rules the sale of a personal residence is subject to a $250,000 exemption. The taxpayer has to have lived in the residence for at least two of the prior five years.

> **For example:** Don bought a house for $30,000 and conveyed it to himself and Debbie as joint tenants. Don dies when the house is worth $300,000. If Debbie has lived in the house for at least two of the prior five years she can sell it for $300,000 and has no tax liability because her total capital gain ($145,000) is less than the $250,000 personal residence exemption she is allowed under State and federal tax rules.

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B. Unnecessary Gift Taxes

A second potential problem that arises when property is transferred into joint tenancy is that it is effectively a gift, and this can present a problem for wealthy people. Under 2009 rules gifts of more than $13,000 must be reported to the IRS, and after $1 million in reported gifts are given away (in a lifetime) Gift Tax must be paid on all additional amounts. For 2009 the maximum tax rate was 45% and for 2010 it is 35%.

> **For example:** Don owned land worth $3 million. He conveyed it to himself and his daughter Debbie in joint tenancy. That effectively gave Debbie a "gift" of $1.5 million. That is $1,487,000 more than the $13,000 limit on gifts that do not have to be reported. Don has to report a gift of $1,487,000 to the IRS, and his lifetime unified credit for Gift Tax purposes is only $1million. As a result he has to pay Gift taxes on the excess gift amount of $487,000 at the end of the tax year. For 2009 that would have been a tax liability of $219,150. And if Debbie sold the land later she may also be liable for capital gains taxes as explained earlier.

In addition, all gifts of this nature become part of the taxable estates of the donors at their deaths and may be subject to estate taxes at that time.

Since the unified credit for Estate Tax purposes shelters $3.5 million, higher than the unified credit for Gift Tax purposes, passing the property through a revocable Trust may result in total tax avoidance.

> **For example:** Don owned land. He conveyed it to a revocable Trust that would give the property to his daughter Debbie at his death. At his death the land was worth $3 million and the rest of Don's taxable estate was less than $500,000. That causes his total taxable estate to be less than the $3.5 million unified credit for Estate Tax purposes for 2009 and Debbie would have received the land free from any estate taxes at all. And she wouldn't have any capital gains tax liability either because she would get a stepped-up basis!

Spousal Transfer Exception. Gifts between spouses are exempt from Gift Taxes so if Debbie was Don's wife in the above examples instead of his daughter there would be no Gift Tax problem.

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C. Potential Loss of Medi-Cal Eligibility

A third problem caused by conveying property to joint tenancy is that it can cause the donor to be ineligible for nursing home services to be paid for by Medi-Cal. When an individual applies to have nursing home expenses to paid by Medi-Cal, the value of all gifts they have given away in the prior 5 years (60 months) are aggregated, and the applicant is penalized by ineligibility for a period calculated from that sum.

> **For example:** Don puts his daughter Debbie on the title to a house that is effectively a gift to Debbie. After that, if Don needs nursing home care and applies for Medi-Cal to pay for it, he will be deemed ineligible for a calculated period of time because of that transfer.

Chapter 18: Tax Advantages of "Community Property"

For married couples, holding title to property as "community property" rather than as "joint tenants" often provides tax savings without any downside. This is seldom taught in law school and **never tested** but it can be an extremely important estate planning issue for clients.

Most law students (and many attorneys) think of "community property" only within the context of "community property law" and how it is treated in divorce situations. That is the only way it is usually tested on Bar exams. But another very important aspect of "community property" is how it is treated under the federal and California tax codes.

When a spouse dies tax rules only give the surviving spouse a "**stepped-up basis**" on HALF of the appreciated assets they held in joint tenancy with the deceased spouse. That wipes out half of the surviving spouse's capital gains. But they get a "**stepped-up basis**" on ALL the assets they hold as community property. That wipes out ALL of their capital gains.

This fact has no importance when it comes to bank accounts, IRAs, 401(k)s, Keoghs, CDs or other assets of that type. Those either have no appreciation at all (e.g. bank accounts, CDs), or they are always taxed as "ordinary income" anyway (e.g. IRAs, 401(k)s, etc.). But it has tremendous importance to the surviving spouse when it comes to real property, stocks, bonds and mutual funds!

California law allows married couples to hold title as "community property" or as "community property with right of survivorship". The latter term is far better than the former when it comes to real property because if the phrase "with right of survivorship" is not expressly stated the surviving spouse has to file a "Spousal Property Petition" in the Probate Court to clear title. If the phrase "with right of survivorship" is included, all the surviving spouse has to do is record an "Affidavit of Death" with the County recorder.

All it takes for a married couple to transmute their jointly-held assets to "community property" is to write the following on a piece of paper and sign it:

> "We, _______ (e.g. Hal and Wanda), hereby expressly transmute our interests in _____ (e.g. "all our real and personal property", specifically described property, etc.) to <u>community property with right of survivorship</u> as that term is defined by California Family Code section 750, whether or not the assets are held by us directly or in a revocable Trust, and ask that this document be considered by any court of law to be an express written statement of that intent to transmute character of property as required by California Family Code section 852.
>
> Dated: _____________ Signed ________ (Hal and Wanda)"

That statement is sufficient to eliminate ALL capital gains the surviving spouse otherwise would be liable for after the death of the first spouse.

> **For example:** Hal invested in stocks and commercial real estate for over 50 years. He and his wife Wanda held everything in joint tenancy. Hal committed suicide at 80 years old in December of 2009 when he found out he had cancer. Wanda was left with a taxable estate of $5 million so she faced an Estate Tax problem. She also had no understanding of the

> stock market investments or how to manage the commercial real estate. She needed to give away $1.5 million, and to do that she needed to sell $1.5 million in assets. Then she could establish a gifting plan and give that amount to her 5 children and 20 grandchildren. She could give away $325,000 a year each year ($13,000 each to her 25 descendents). She could give away $325,000 in December 2009, $325,000 the next month in January 2010, and $325,000 each January after that until January 2013. Then her Estate Tax problem would be resolved (using 2009 rules). But she and Hal had held their investments for so long that the vast bulk of her holdings consisted of unrealized capital gains. When she sold the $1.5 million in assets it caused her to incur $175,000 in taxes that she would have completely avoided if only she and Hal had signed that simple little statement shown above! [13]

If a married couple does not have any appreciated property, none of this matters because the survivor will not have any capital gains tax problem at all. And if their only appreciated asset is their personal residence, the $250,000 capital gain exemption for "sale of a personal residence" is often enough to eliminate the problem as well. But if a married couple owns <u>stocks, mutual funds, second homes, farmland</u> or <u>investment properties</u> (residential rentals, commercial buildings, and unimproved land) this becomes a very important issue.

[13] This is a true story. Wanda was my client.

Chapter 19: The Need for Pour-Over Wills with Trusts

Even after clients convey all of their assets into a revocable Trust they still need to have a "pour-over" Will that provides all of their real and personal property belongs to that Trust anyway. It is simply malpractice for an attorney to provide a client with a revocable Trust without having them execute a pour-over Will as well.

The reason clients need a pour-over Will of this sort, even though they have stated in the Trust that they are giving all of their real and personal property to the Trust, is that they may hold title to property outside of the Trust when they die, despite their best efforts to avoid it.

> **For example:** Grant wanted all of his estate to go to his lover, LeRoy, if he died. So he created a revocable Trust that said he was "hereby giving" all of his personal and real property to the Trust, and the Trust instrument said that at Grant's death everything in the Trust was to go to LeRoy. Grant put all of his real property into the Trust. Then Grant's father, Adam, died leaving Grant the family estate, Blackacre, in his Will. But Adam's estate had to go through probate. Grant died before probate of Adam's estate was concluded so he never had title to Blackacre and could never deed it into his Trust. If Grant died with a pour-over Will that said everything he owned went to his Trust, Blackacre would be conveyed to the Trust after probate of Grant's Will. Then it would go to LeRoy under the terms of Grant's Trust. But if Grant died intestate Blackacre will be distributed according to the rules of intestate succession, and in that case LeRoy would not get it.

Since a pour-over Will is simple to create (they consist of about 4 pages) it is simply negligence for a probate attorney to fail to create one when creating a Trust.

Chapter 20: Estate Planning under Prop 13

Effective estate planning in California requires awareness of the effects alternative transfer strategies will have on property taxes under the limitations of Proposition 13 ("Prop 13") and its progeny. This is never taught in law school and **never tested**.

"Proposition 13" was adopted by the voters in about 1976 and it severely limits California counties from raising property taxes on real property. The statutes it enacted prevent Counties from increasing real property assessed values faster than the inflation rate, measured by the Consumer Price Index, or 2% per year, whichever is less, as long as it is owned by the same owner. As a practical matter the 2% cap is almost always less than the inflation rate so effectively Prop 13 limited property tax increases to 2% a year.

In addition, Prop 13 sharply limited the property tax rates Counties can levy, and in most cases property tax rates are limited to about 1.1% of assessed value.

However, if real estate is sold or conveyed the Counties are allowed to reassess the property to the current market value.

> **For example:** Grampa owned his residence, Blackacre, in 1976 when it had a fair market value of $100,000. At that time his annual property taxes were $1,100, or 1.1% of assessed value. After 1976 the value of his residence increased in value to $1 million. But the assessed value only increased to $196,068 because of Prop 13, and his annual taxes only increased to $2,157. If Grampa dies the County might be able to increase the assessed value of Blackacre to the actual market value, $1 million, and the new owner's annual property taxes would be $11,000.

But in 1986 Proposition 58 was approved and the statutes it enacted prevent Counties from increasing assessed values to market value when parents convey their personal residences and up to $1 million in other real property to their children. This is called the "**parent-child exclusion**". Then in 1996 voters passed Proposition 193. That prevented Counties from increasing assessed values to market value if the same type of real property is conveyed from grandparents to grandchildren, but only in certain circumstances. This is called the "**grandparent-grandchild exclusion**". This is all codified at California Rev. & Tax Code § 63.1.

Counties from are only prohibited from increasing assessed values of land given by grandparents to grandchildren <u>if, and only if, the intervening generation (the children of the grandparents who are the parents of the grandchildren) are deceased</u> at the time of the transfer. If the intervening generation (the "linking parent") is not deceased, the County will reassess the property. Further, the California Board of Equalization will not treat the "linking parents" as being deceased simply because they disclaim their interests pursuant to CPC §§ 260 et seq. [14]

Consequently, it is very important to use caution when drafting Will and Trust provisions conveying real property from grandparents to grandchildren. It is often very important to pass title to the property through the "linking parent" on its way to the grandchildren.

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[14] See their website at www.boe.ca.gov/proptaxes/faqs/propositions58.htm.

For example: Gramps wants to give his residence, Blackacre, to his favorite grandson, Sonny, when he dies. Sonny is the son of Gramps child. If Blackacre goes directly from Gramps to Sonny, it is not going to qualify for the "grandparent-grandchild exclusion" if Hannibal is still alive, and that would substantially increase Sonny's property taxes. But if the property is given from Gramps to Hannibal first it qualifies for the "parent-child exclusion" and property taxes cannot be increased. Then Hannibal can give Blackacre to Sonny, and that qualifies for a second "parent-child exclusion". If the land is passed in this two-step process the property taxes cannot be increased.

However, it is important to consider all other considerations when formulating a strategy of this type. The impact of Gift Taxes, and potential claims of creditors and public agencies against the "linking parents" must be considered. An alternative approach would be to make the "linking parent" a life beneficiary of the Trust.

For example: Gramps wants to give his residence, Blackacre, to his favorite grandson, Sonny, when he dies. Gramps could create a revocable Trust that makes his son Hannibal the life beneficiary and Sonny the principal beneficiary. When Gramps dies the conveyance of a life estate to Hannibal (as a life beneficiary) is considered a "parent-child" transfer. Hannibal might allow Sonny to live in or use Blackacre during his. Then when Hannibal dies the transfer of title to Sonny qualifies for the "grandparent-grandchild exclusion" because it would take place after Hannibal is dead.

Chapter 21: Conclusion

This outline provides a summarized explanation of **CALIFORNIA WILL and TRUST LAW** as set forth in the California Probate Code and tested on the California General Bar Exam. In addition it explains a lot of things you need to adequately practice probate law and estate planning in California.

Virtually all of the rules of law you need to know to succeed on law school and California Bar Exams has been presented here.

Each professor of law, in every subject, holds a keen interest in narrow areas of the law of personal interest. Frequently this interest is based on their own legal education or their experiences in the courts. When your professor expounds on an area of law given summary treatment in this outline it will be necessary for you to consult authoritative reference materials such as hornbooks to gain a greater understanding.

If your professor is adamant about some theoretical concept note that proclivity and modify your explanation of the law as necessary to humor those proclivities. But, you will find the Bar examiners far less interested in such marginal issues and much more concerned with the breadth of your knowledge of the rules of law set forth herein.

Other than those cases where a professor demands further knowledge in a narrow area, the foregoing should be entirely sufficient to impart an adequate **understanding** of **California Will and Trust Law**. However, mere **understanding is NOT ENOUGH** for you to succeed. Law school and the Bar examinations require **both understanding** and ability to **explain the application** of the **law to the facts and facts to the law**.

This outline is NOT written for the purpose of explaining to you how you should explain the law on your examinations. You are urged to consult **How to Write Essays for Wills and Trusts Law School and Bar Exams (HIe)**. Information about that publication is available inside the back cover of this outline.

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