

Message From The Firm

This month's newsletter addresses three new developments in estate planning, one or more of which may impact each and every reader. First, we feature an article by Kyle Neal addressing new FDIC insurance limits on bank accounts held by Living Trusts. The FDIC has finally responded to concerns that the previous FDIC limits created a conflict between proper estate planning and financial protection. This article should be of interest to most of our clients and to all of the accountants and business managers that receive this newsletter.

We also feature an article by David Schwartz and Kalyani Chirra on the new California law requiring that many persons who act as trustees for clients or others register with the State of California. This new law will impact virtually all of the accountants and business managers who receive this newsletter.

We close with an important article, also by Kyle Neal, addressing the recent changes in California law regarding domestic partnerships. Often overlooked is the fact that California domestic partner law can apply not only to same-sex couples, but also to older men and women who have resisted marriage in order to preserve various financial interests such as Social Security benefits, pensions and the like.

Please feel free to contact the authors of each of these articles if you have any follow-up questions.

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FDIC Announces New Rules for Revocable Living Trust Accounts

By Kyle Neal (KyleNeal@Reish.com)



On January 13, 2004, the FDIC adopted new rules for insurance coverage of living trust accounts. The new rules went into effect on April 1, 2004.

The FDIC, established in 1933 to restore public confidence in the nation's banking system, insures deposits for an individual account owner at a member bank for up to \$100,000. However, many people in California and in other states don't own their accounts in their individual names. As part of their estate planning, many individuals hold title to their assets, including bank accounts, in the name of their revocable living trusts. Under the old FDIC rules, it was questionable if the FDIC insurance coverage extended to funds held in the name of a typical living trust.

The Old Rule. Under the old FDIC rules, if a revocable trust qualified for special treatment, then the amount of FDIC insurance was equal to \$100,000 times the number of "qualifying beneficiaries," and such coverage was separate and apart from insurance otherwise available for the owner of the trust and the beneficiaries.

In order to qualify for the special treatment, the trust had to satisfy three conditions:

1) The owner had to evidence his intent that upon his death the funds would

belong to one or more qualifying beneficiaries. This meant that banks were required to keep the names of the trust beneficiaries in the bank's account records. If a depositor revised his living trust to add or delete a beneficiary, the bank was supposed to be notified to revise its records.

- 2) The qualifying beneficiaries could only include the owner's spouse, child/children (including adopted children or stepchildren), grandchild/grandchildren, parent, brother or sister.
- 3) The interests of the qualifying beneficiaries could not be subject to a "defeating contingency."

This third requirement of no "defeating contingency" was a big problem. Many living trusts did not qualify for per-beneficiary coverage because they contained standard survivorship provisions that were "defeating contingencies" (such as a provision that a beneficiary must survive 21 days to be considered to have survived the settlor of the trust).

The New Rule. Under the new rule, the "defeating contingency" limitation is gone, as is the requirement to keep the names of the trust beneficiaries in the bank's account records. Under the new rule, a living trust account will be insured up to \$100,000 per beneficiary (other than the owner himself) if all of the following requirements are met:

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The beneficiary must be the owner's spouse, child, grandchild, parent or sibling. Stepparents and stepchildren, adopted children and similar relationships also qualify. In-laws, cousins, nieces and nephews, friends, and charitable organizations do not qualify.

The beneficiary must become entitled to his or her interest in the trust when the owner dies. Coverage would be based on the beneficiaries who meet this requirement at the time the bank fails. Example: A living trust names an owner's three children as beneficiaries but states that each beneficiary's share will pass to the beneficiary's children if the beneficiary dies before the owner. Assuming all three children are alive at the time the bank fails, only the children — not the grandchildren — would be beneficiaries for insurance purposes. (That's because the grandchildren are not entitled to any trust assets while their parent is alive.) Coverage up to \$300,000 (\$100,000 per beneficiary) would be available on the trust's deposit accounts.

The account title at the bank must indicate that the account is held by a living trust. This rule can be met by using the terms "living trust" or "family trust" in the account title.

Coverage is based on the actual interests of each qualifying beneficiary. Unless the trust states otherwise, the FDIC will assume that the beneficiaries have an equal interest in the living trust account. Example: A father has a living trust leaving all trust assets equally to his three children. This trust's account would be insured up to \$300,000 since there are three qualifying beneficiaries who would become owners of the trust assets when the owner dies. It will no longer matter if the trust says that a child does not get

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New Rules Require Trustees to Register with the State



By David Schwartz (DavidSchwartz@Reish.com) and Kalyani Chirra (KalyaniChirra@Reish.com)



Under a recent change in sections 2850-2855 of the California Probate Code, any individual serving simultaneously as trustee of trusts for more than three people or for more than three families, or a combination of people or families that totals more than

three, is required to register with the Statewide Registry maintained by the California Department of Justice, by January 1, 2005, and reregister every three years thereafter. The law makes no distinction between revocable and irrevocable trusts, or the extent of the assets held in the trusts. We also understand from conversations with the Statewide Registry that acting as a co-trustee will "count" toward the trust minimum. Failure to register will subject the individual to a civil penalty of \$200 for the first violation, and \$500 for each subsequent violation. Also, the new law requires that the individual be removed as trustee by the court for failure to register.

In determining whether an individual is serving as trustee of trusts for more than three people or three families, separate subtrusts created by a single trust instrument will be counted as separate trusts. However, separate subtrusts for, e.g., siblings unrelated to the trustee, will qualify as one trust for purposes of meeting the trust "minimum." Trusts that hold life insurance policies on the life of the still living grantor are counted for this purpose, as well as trusts that hold legal title to a client's residence. The new law does not

apply to trusts in which the trustee is related by blood, marriage, adoption or registered domestic partnership (as well as qualifying domestic partnership relationships) to the grantor of the trust. Thus, a trust administered for the benefit of a family member of the trustee will not count in determining whether the trustee is administering trusts for more than three people or more than three families.

In order to register with the Statewide Registry, the trustee is required to file a declaration that includes information about educational background, professional experience, verification of any college or graduate degree claimed, the names of the trusts being administered by the trustee, the aggregate dollar value of all assets in the combined trusts under the trustee's supervision, whether the trustee has ever been removed for cause or resigned as a trustee, and the circumstances surrounding any removal or resignation. Any intentionally false statement on the declaration is punishable by a fine and/or imprisonment.

Registration forms are available on-line at <http://www.caag.state.ca.us/conservator/index.htm>. In order to avoid imposition of fines and court removal as trustee, each trustee should confirm the number of trusts he or she is administering that are subject to the reporting requirement. If a trustee meets the reporting threshold, he or she must register by January 1, 2005.

Please call us if you would like our guidance in determining whether a reporting requirement exists or in assisting with the filing with the Statewide Registry. ❖

Estate Planning for Same Sex Couples is Undergoing Change



By Kyle Neal (KyleNeal@Reish.com)

Prior to the advent of domestic partner registration laws (and now, in Massachusetts, same sex marriage), an estate plan for an unmarried same sex couple was essentially two estate plans for two single persons. Even though the two people presented themselves to the world as a couple, and perhaps informally referred to themselves as “married,” the union was not recognized as having any special significance in terms of property ownership, property rights or tax treatment.

“...relying on intestate succession means that the decedent’s estate will be subject to Probate, and there will be no opportunity to engage in any estate tax planning.”

The new California domestic partner registration law that will go into effect on January 1, 2005, allows a same sex couple to enter into the world of community property. For registered domestic partners, like married persons, property acquired after the date of registration, with past registration funds, will be deemed community property, half owned by each. Like persons contemplating marriage, same sex couples contemplating registration will need to consider if they want to opt out of some or all of the community property laws that would apply, by entering into an agreement that determines their property rights. As with

married couples where earning capacity may differ, the higher earner may not want to cede ownership of half of his earnings to the other partner. A couple may decide to forego registration altogether, or, if other aspects of registration are desired, may enter into a form of “prenuptial agreement.”

After January 1, 2005, domestic partners will fall into three categories:

- 1) Registered domestic partners who accept the full reach of the community property laws;
- 2) Registered domestic partners who have varied the reach of the community property laws by agreement; and
- 3) Domestic partners who have chosen not to register and therefore who will have no community property.

Once a same sex couple has sorted out who owns what property (all separate, all community, some mix of separate and community), each of the partners then needs to create an estate plan that will ensure that his expectations as to the disposition of his property are met.

Relying on intestate succession (*i.e.* no estate plan) is unlikely to produce the desired results. For an unregistered couple, California intestate succession law will not cause a decedent’s property to be distributed to a partner. California intestate succession laws for unmarried/unregistered persons cause the decedent’s property to be distributed first, to any children, then to parents, siblings, etc. For registered domestic partners, the intestate succession laws will apply as they would for a spouse. However, relying on intestate succession means that the

decedent’s estate will be subject to Probate, and there will be no opportunity to engage in any estate tax planning.

There are several ways a same sex couple can organize their property interests for estate tax purposes. One, as noted above, is to register and to enter the world of community property. The couple could then sign an agreement to elect the “aggregate” theory of community property, rather than the “item by item” theory. The couple could then create a joint trust, funding it with the community property. At the first death, the survivor could pick and choose which assets he wanted as his “half” and the balance could then be held in trust for the survivor’s lifetime (after payment of estate tax, if any). For example, the million dollar house could be allocated to the survivor, and, the million dollar portfolio could be allocated to the decedent’s trust. The portion held in trust could, at the second death, pass to the family/friends/charities of the first partner to die, as set forth in the trust.

If a couple decides not to register, or registers but has a “prenup” that limits the application of community property laws, the couple should consider creating an agreement to define the relationship and the property ownership. For example, a couple may purchase a house as tenants in common. They should then enter into a co-tenancy agreement to establish their mutual rights and obligations. Such an agreement would cover the procedure for payment of any mortgage, and payment of taxes, insurance and upkeep. The agreement would also provide a procedure for buyout by one party, including a procedure to select appraisers and a procedure to determine who will purchase from whom in the event of death, breakup or similar event. The agreement might contain a provision for the deceased partner to leave his interest to the other, but this step would also have to be documented in a Will or living trust. Such an agreement can also establish that one part-

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his or her share until a certain age, or until graduation from college, or unless the child survives the parent by 21 days. Note that the owner himself is ignored in the calculation of the coverage for the living trust. He may, however, have an account in his own (non-trust) name with separate coverage of \$100,000.

Unless otherwise indicated in the trust, the FDIC will assume that a beneficiary with a life estate interest owns an equal share of the trust with the other beneficiaries. Example: A husband creates a living trust giving his wife a life estate interest in the trust assets with the remaining assets going to their two children equally upon his wife's death. Deposits for this trust could be insured up to \$300,000 (\$100,000 for each qualifying beneficiary – the wife and two children).

Living Trusts with more than one owner.

If a living trust has more than one owner, then during the co-owners' lives, coverage will be up to \$100,000 per qualifying beneficiary for each owner, provided the beneficiary would be entitled to receive the trust assets when the last owner dies. Example: A husband and wife are co-owners of a living trust. The trust states that upon the death of one spouse the funds will pass to the surviving spouse, and upon the death of the last owner the funds will pass to their three children equally. This trust's deposit account would be insured up to \$600,000 during the time that both husband and wife are living.

When one owner dies, however, this coverage will change. Assume a typical husband and wife trust that divides at the first death into a revocable survivor's trust and an irrevocable marital trust. Now, the surviving spouse will have \$300,000 of coverage for the survivor's trust (\$100,000 per child), but the marital trust

will have only \$100,000 of coverage under the rules applicable to irrevocable trusts. This is because once a trust becomes irrevocable, the assumption that all beneficiaries are equal does not apply; the survivor may consume all of the assets of the marital trust through income distributions and invasions of principal, so only \$100,000 of coverage is available for the survivor's life estate in the marital trust.

There is another anomaly in the coverage. If husband and wife create a joint trust, with their three children as the ultimate beneficiaries, then as noted above there is \$600,000 of coverage while they are both alive, because for purposes of calculating coverage both of the grantors are ignored, even though they will each be beneficiaries of the other's share. If the same husband and wife each created their own separate living trust, then while each spouse was alive, there would be \$400,000 of coverage for each spouse's living trust: \$300,000 for the children, and \$100,000 for the life estate for the spouse, for a total of \$800,000.

Coverage for a beneficiary who is not the owner's spouse, child, grandchild, parent or sibling. The trust interest of a non-qualifying beneficiary is insured as the owner's single ownership funds and would be added to any other single ownership funds the owner may have at the same bank, and the total would be insured up to \$100,000. Example: A living trust states that the trust assets will belong equally to the owner's husband and nephew upon her death. If the trust's account has a balance of \$200,000, her husband's share (\$100,000) would be insured as her revocable trust funds and her nephew's share (\$100,000) would be insured as her single ownership funds. If, for example, the owner already had a single ownership account for \$20,000, the nephew's interest (\$100,000) would be added to her other single ownership funds and the total would be insured for \$100,000, leaving \$20,000 uninsured.

Living trust accounts and "payable on death" accounts are added together under the new rule. The \$100,000 per-beneficiary insurance limit applies to all revocable trust accounts – payable on death (POD) and living trust accounts – which an owner has at the same bank. Example: A father has a POD account naming his son and daughter as beneficiaries and he has a living trust account naming the same beneficiaries. The funds in both accounts would be added together and the total insured up to \$200,000 (\$100,000 per qualifying beneficiary). ❖

Domestic Partners

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ner is not making gifts to the other partner by paying the joint living expenses.

Alternatively, a couple can also hold property (real property, bank accounts, stock accounts) as joint tenants, with right of survivorship. This has the advantage of simplicity of administration at the first death. It also means that the survivor will wholly control the disposition of the property at the survivor's death, and the same property may be subject to estate tax twice. Also, there may be a gift at the creation of a joint tenancy if both partners do not contribute equally.

The federal estate tax consequences for domestic partners have not yet caught up with the changes in the state law. Same sex partners are prohibited from filing a joint income tax return. There is still no estate tax marital deduction for same sex couples at the federal level, even in Massachusetts where a same sex couple can truly be married. This means that there can be no deferral of estate tax at the first death. This may require purchase of a life insurance policy, preferably in a life insurance trust. In order to minimize overall taxes, property can be left to the surviving partner in trust for life, so there is no estate tax on the survivor's death. ❖

Around the Firm

Brad Cohen and David Schwartz co-presented a "Tax Update" seminar to business managers on November 4th in Los Angeles. Brad was a member of the planning committee for the California CPA Education Foundation's 2004 Entertainment Industry Conference in Beverly Hills on October 26th. Brad also moderated a session on "Music: Adapting to the Changing Business Model" at the Conference. Jon Karp was on the planning committee for the California CPA Education Foundation's Tax Planning for High Net Worth Individuals Conference, held in Irvine on October 21st and in San Francisco on October 22nd.

Kyle Neal is giving a presentation in Woodland Hills in December to the Valley Estate Planning Council on the topic of "New Domestic Partner Law and the Estate Planning Implications."

Our attorneys frequently give presentations on a variety of business, tax and estate planning topics to business management and accounting firms. If your firm needs continuing education hours, please contact Traci Mortimer in our office at (310) 478-5656 ext. 231 and she can schedule a seminar for your firm.

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