A Short Review of Death and Taxes in California in 2013

By Jan Cummins
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There is a very old saying that nothing is inevitable except Death and Taxes, and estate plans have traditionally focused on two major items:

1. The passage of property at death
2. Tax issues that arise at death.

Passage of Property at Death

There are basically three ways that property can pass to another at death in California:

1. Through a **Will**;

2. Through a **Revocable Trust**;

3. By **Force of Law**, including but not limited to:
   - **Form of Title** on a deed or account, including joint tenancy title or beneficiary transfer on death (TOD) designations;
   - **Legal Claims**, especially the claim of Community Property by a surviving spouse and Homestead and Family claims;
   - **Intestate Succession Law**.

One or more of these legal processes will determine how a person's property will be distributed after death.

Will. A Will is the traditional document that can provide for smooth passage of property at death. More formally it is known as a Last Will and Testament. A Will only has legal force after the death of its creator (the "testator.") In California, while a simple handwritten Will, known as a "Holographic Will", is a legally binding last Will and Testament, most people who create a Will make sure that it is a formal one created by and executed with a lawyer. After deat, the original Will, if there is one, must be filed with the probate court in the county where the deceased person resided most recently. That county is recognized by the Court as in control of the passage of all of the deceased person's personal property that is mentioned in the Will that does not pass by some other legal method, and all real property located in California. All documents filed with the Court are a matter of public record, and a Will is no exception.

Revocable Trust. The Revocable Trust format became popular 30 or 40 years ago as a Will substitute that would avoid a court probate of the estate after death, and as a way to ensure the privacy the deceased person's estate. This type of trust became even more popular because of its strong secondary purpose for married couples, protecting the estate tax exclusion amount for the first spouse to die and thus reducing or eliminating estate taxes. With the passage of the 2013 permanent estate tax law locking in an exclusion amount of $5,000,000 per person, indexed for inflation, this secondary reason is now removed for married couples whose estate value is under $10,000,000. The primary purpose of the Revocable Trust, avoiding court probate, still remains. In addition, there are other reasons for some families to use a Revocable Trust for passage of property at death, particularly in blended family situations. For those families it can be used to provide financial support for the surviving spouse, but will also preserve the remainder of the deceased spouse's property for his or her heirs at the death of the surviving spouse.

A Revocable Trust will automatically become an irrevocable Testamentary Trust at the death of its creator ("settlor"), and thus is technically a legal substitute for a Will. However, to be sure that all property passes according to the decedent's wishes, there should also be a Will. This is because a trust can only own property that has been fully transferred to it, including the proper titling of each item.

Force of Law. Under almost all U.S. law, every person has a right to absolutely decide where their property goes after their death. If an individual does not exercise that right, the law provides a backup plan for where that property will go at death. The government has such laws because of its vested interest in all property being owned by someone.

> **Force of Law: Form of Title.** Joint Tenancy or TOD beneficiary designations will pass property directly to another person at the death of an owner, outside of a Will or a Trust. Form of Title is the only Force of Law category that always ensures that property will pass according to the decedent's instructions independently of instructions in a Will or a Trust. It is an excellent way to pass property to an individual or individuals without the necessity of creating a trust, but it can also be dangerous if not carefully considered. It will preempt the Will and the Trust and might therefore destroy an otherwise well-crafted plan.
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> **Force of Law: Legal Claims.** Certain individuals can claim the decedent's property regardless of the instructions in the decedent's Will or Trust. Those individuals must have been in a particular legal relationship with the decedent during his or her life. Examples are a spouse and/or minor children. For instance, the decedent's share of community property will pass to the surviving spouse if no other provision is made for it by the decedent in his or her Will or Trust. However a spouse and dependent children can claim Family Homestead rights that may prevail over distribution instructions in a Will or a Testamentary Trust. Such claims may require probate court action, but not always.
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> **Force of Law: Intestate Succession**. For those who haven't planned in advance, the law has an estate plan for that person. That plan is called intestate succession. In the

United States this subject is always set by State law and can vary from State to State. In California, the decedent's intestate heirs are his or her spouse and/or children or their issue, or if none, the decedent's parents or their descendants, or grandparents or their descendants, until someone living is found who will take the property.

Taxes at Death

There are at least three types of taxes that must be addressed upon every death of a U.S. citizen or permanent resident in California.

1. **Income taxes**: ordinary income and long term capital gains;

2. **Property taxes**;

3. **Estate (or "death") taxes**.

Income Taxes. There are two type of income tax that need to be paid: ordinary income taxes and long term capital gains taxes.

Ordinary Income Taxes. Ordinary income taxes (earnings from employment, investment income, and short term capital gains) must be paid on income the decedent earned or that was earned on the decedent's investments before the date of his or her death.

Long Term Capital Gains Taxes. Long Term Capital Gains taxes are a special kind of income tax that the federal tax system applies to long term investment gains. (Under California law, state taxes on long term capital gains are levied at the same rate as for ordinary income.) The biggest single long term capital gains tax issue in an estate often involves the decedent's home. It is possible or even likely that an elderly person has lived in the same home for a very long time and has experienced a large gain in the fair market value of his or her home. Careful estate planning can help to reduce or eliminate this tax.

Property taxes. The tax rate on real property can vary enormously in California, due to Proposition 13, passed in the late 1970's. Elderly people who have owned real estate for a long time will usually have very low property taxes. Proposition 13 severely limits any increase in such taxes unless and until the property is sold and can be reassessed at current market value. If a person dies owning real property, the low property taxes on the decedent's home and some other real property can be inherited by the decedent's children or grandchildren under some circumstances, upon application to the County in which the property is located. An estate planning attorney can explain the extent to which your particular estate may be eligible for this tax break.

Estate taxes. Also called "death taxes" by some politicians, estate taxes, gift taxes, and generation skipping transfer (GST) taxes are all part of the federal unified transfer tax plan. Such taxes no longer are a major issue for the vast majority of U.S. citizens, as the unified exclusion amount has been permanently set at $5,000,000 per individual indexed annually for inflation. Also, a new feature added to the unified transfer tax in 2010 and made permanent in 2013 is the "portability" option. This option permits the surviving spouse to claim the full estate tax exclusion allowed to the deceased spouse. This feature permits the surviving spouse to apply the available remaining estate tax exclusion at the second death, effectively doubling the exclusion amount. The result is that now only those married couples with net worth in excess of $10,000,000 plus the inflation indexed amount at death are required to pay estate taxes.

Conclusion

Customized estate planning can help to reduce or eliminate taxes at death. An important component of estate planning is knowing how to use the various legal methods for passing on property at death, and what limitations the law may place on your ability to determine the passage of your property at your death. Consultation with an estate planning attorney who can address your own unique situation and concerns is essential for smooth and cost effective passage of property to beneficiaries at the death of a property owner.

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