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2007 Updates

Hoffman, Sabban & Watenmaker strives to keep our clients and friends informed of important developments affecting their estate and tax planning. This letter summarizes some of those developments.

I. <u>Changes in the Gift, Estate & Generation-Skipping Transfer Taxes</u>.

In 2008, the lifetime exemption from **gift** taxes remains $1,000,000, and the exemptions from **estate** taxes and **generation-skipping** transfer ("GST") taxes each remain $2,000,000. The top rate for all of these taxes is 45%. The estate and GST tax exemptions are scheduled to increase to $3,500,000 in 2009, just about a year away.

Any portion of the $1,000,000 gift tax exemption used for lifetime gifts reduces the maximum allowed estate tax exemption. Thus, if a person who dies in 2008 had previously used $400,000 of the lifetime gift exemption, then the remaining estate tax exemption is $1,600,000 ($2,000,000 minus $400,000). In addition, if the lifetime gift is a generation-skipping gift (e.g., to a grandchild), then the gift amount is also offset against the $2,000,000 GST tax exemption.

In 2008, the annual "per recipient per donor per year" gift tax exclusion will remain at $12,000 (in addition to the unlimited gift tax exemption for amounts paid <u>directly</u> for school tuition or medical expenses).

The future of gift, estate and GST exemptions and rates still remains murky. Senators Kyl and Baucus are continuing to work on a compromise, but recent reports indicate that it is unlikely that Congress will act before 2009. Some Republicans are reportedly planning to undercut compromise efforts until some time in 2010, a year in which the estate tax is scheduled to be eliminated (but only for that year), hoping to gain more leverage in the negotiations. Since it takes at least 60 votes in the Senate to stop a filibuster and get a bill passed, achieving a compromise is difficult.

II. <u>Transfers from IRAs to Charities</u>.

Until the end of 2007, a person over age 70-1/2 can transfer up to $100,000 directly from an IRA (<u>other than</u> a SEP-IRA or a "Simple Retirement Account") to a charity without taking the income into account (and obviously without taking a deduction). The charity must be a public charity other than a Donor Advised Fund or a Supporting Organization. This provision benefits people who do not itemize deductions, or who otherwise give contributions to charity in excess of 50%

of their adjusted gross income, and in certain other cases where including additional amounts in income causes the loss of itemized deductions or increases the amount of social security income subject to tax.

III. **Revisions to "Kiddie Tax"**.

Effective for 2008, unearned income in excess of $1,700 of (i) a child under age 18, or(ii) a dependent child under age 24 who is a full-time student, will be taxed at the parent's income tax rate. For 2007, this rule does not apply to a child over age 18, so if you have a child who is between 18 and 23, it might be advantageous to accelerate the child's income (such as by selling appreciated assets) before year end.

IV. **Property Tax Change of Ownership for Life Estate Transfers**.

A recent case decided by one of the California Courts of Appeal, *Steinhart v. County of Los Angeles,* held that where a decedent granted a life estate in trust to her sister, the real property in the trust was not subject to a reassessment for property tax purposes. While we believe that this case was wrongly decided, clients may wish to apply for a protective claim for refund if this situation applies to them. For example, if a parent died and left assets in trust for a child or grandchild for life, and the parent-child exemption from property tax reassessment did not apply (for example, because more than $1,000,000 of assessed value was transferred), the child may wish to file a protective claim for refund.

V. **Charitable Planning Changes**.

Many rules went into effect in 2006 and 2007 regarding deductions for gifts to charity and tax rules for charities.Generally, if a tangible asset (for example, a work of art or a boat) is given to an organization that does not use the item in connection with its exempt purpose, your deduction is limited to the lower of its income tax basis or its fair market value. That rule is now expanded so that even if the item is given to a qualifying charity (e.g., art to an art museum), if the item is disposed of in the year of contribution, the deduction is limited to the donor's basis unless the charity issues a certification that it was the organization's intent to use it for the charity's purpose but that intent became impossible or infeasible to implement. If the charity disposes of the work after the year of contribution, but within three years of the contribution, then the donor must recapture in income the appreciation as of the date of contribution unless the charity gives a certification similar to the one discussed in the preceding sentence. Charities must now report all such dispositions made within three years of a contribution.Among the many other changes are the following: Most private foundation taxes were doubled. Generally, it no longer makes sense to give a fractional interest in a work of art to a museum. A cash deduction (even by check) won't be allowed (regardless of amount) unless the donor maintains a bank record of the donation or the charity acknowledges the gift in a writing that shows the donor and the amount of the donation. Generally, a charity must certify in writing what, if anything, the donor received in exchange for a contribution. A contribution from a private foundation to certain supporting organizations will no longer qualify as part of the private foundation's minimum 5% annual distribution. There are many other changes too numerous to mention, and you can contact Hoffman, Sabban & Watenmaker if you wish to receive a complete analysis of these new laws.

VI. Registered Domestic Partners. Since 1999, a gay or lesbian couple, or a heterosexual couple where one partner is at least 62 years old, can become Registered Domestic Partners ("RDPs"). Since 2005, most California laws (other than income tax laws) that apply to a husband

and wife began to apply to RDPs, including community property for earnings during the relationship, and alimony following termination of the relationship. The community property law applies to all earnings of the couple from the date of registration, even if that occurred before 2005. Effective for 2007 and thereafter, RDP members must file California income tax returns on the same basis as married persons (i.e., a joint income tax return, or a filing as "married filing separately".) However, they must continue to file as unmarried persons for federal income tax purposes. Beginning in 2006, all transfers of California real property between RDPs (either during life or upon death) allow the recipient Partner to retain the "Proposition 13" property tax basis of the transferring Partner. A 2007 change applies this property tax exemption retroactively to transfers made in or after 2000, but only if an application for "reversal of reassessment" is made before June 30, 2009. However, no refunds of property taxes will be made for years before the application is filed. Still, if your RDP died between 2000 and 2006, and you inherited real property from him or her, this new law may substantially reduce your property taxes for 2007 and future years.

VII. Professional Trustees. The current California law regarding "professional fiduciaries" was again amended, effective in 2009 (or for persons appointed by a court after June 30, 2008). Under the new law, lawyers, CPAs and "enrolled agents" (who are authorized to represent clients before the IRS) will be exempt from becoming licensed. The new law requires that any other individual who is the trustee or agent under a power of attorney for the benefit of more than three persons or families register with the "Professional Fiduciaries Bureau" of the Department of Consumer Affairs. (It also applies to a person who is a guardian or conservator for two or more persons.) In determining whether this requirement applies, you count the number of trustors (creators of the trust), rather than the number of trusts or beneficiaries. The term "family" is defined as persons related by blood, marriage, adoption, registered domestic partnership or a relationship meeting the basic requirements of a domestic partnership even if the persons are not registered. A trustee need not count any trust where the trustor is related to the trustee by blood, marriage, adoption, registered domestic partnership or a relationship meeting the basic requirements of a domestic partnership. New regulations were recently adopted, and additional regulations have been proposed. These include 15 hours of annual continuing education, and annual licensing fees, and impose possible criminal sanctions for failure to comply with the law. Details can be obtained at http://www.fiduciary.ca.gov/laws_regs.**VIII. New Notarial Acknowledgment Form.**

Starting in 2008, a notary public must obtain "satisfactory evidence" (generally, a driver's license or passport) of the identity of a person for whom he or she signs an acknowledgment. It will no longer be possible for the notary to indicate that the notary personally knows the person signing the document. Also, the notary will have to obtain a fingerprint of the signer for powers of attorney, as well as for deeds and other documents affecting title to real property.

IX. Deceased Celebrity's Right of Publicity.

In general, California law now provides that the right of publicity of a deceased celebrity can be controlled by the celebrity's beneficiaries under a Will or living trust, or the celebrity's heirs if the person died intestate, even if the celebrity died before 1985. Prior law was only effective with respect to celebrities who died in 1985 or later. To properly enforce the rights of the beneficiaries or heirs, they must register with the State of California.

X. **Family Limited Partnerships or Limited Liability Companies**.

Limited partnerships and Limited Liability Companies ("LLCs") continue to be a useful way of obtaining valuation discounts on assets, in order to reduce estate taxes on assets passing to family members. However, recent court decisions emphasize the need for careful planning and operation of the partnership or LLC. There must be a non-tax reason for establishing the partnership or LLC, the transferors must retain enough assets outside of the partnership or LLC to handle their own normal living expenses, and distributions should be made in proportion to partnership or LLC interests. A partnership or LLC established shortly prior to the transferor's death may be ignored by the IRS and the courts.

XI. **Title To Assets**.

If you have a living trust, be sure that title to your assets (other than a personal car and small checking account) are held by the Trust. If you do not have a living trust then, in general, your assets should **not** be held in joint tenancy, since this probably will thwart your intentions as expressed in your Will, and may produce a worse income tax situation for your heirs.

XII. **State Transfer Taxes**.

Many states (but not California) have state estate or inheritance taxes which can increase the amount of estate tax payable where there are assets in those states at the time of death (for example, a vacation home in that state), as well as for decedents who are residents of those states. The states are: Connecticut, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Vermont, Virginia, Wisconsin and Washington. These taxes can be quite onerous, and often apply to estates far below the federal estate tax exemption (often as low as $675,000). If you own real estate in another state, or have valuable tangible assets (such as paintings) in another state, then you should speak to us or a lawyer in the state in which the assets are located, to see if it may be possible to "shift the situs" of the assets (for example, by transferring the assets to a limited liability company formed outside of the state in question). In some cases, these states do not have gift taxes, and it may be less expensive to transfer the property during your lifetime (even if it means incurring a federal gift tax) rather than to wait until death. If you own assets in another state, and want to be certain that no estate taxes will become payable on the first spouse's death, even if that means that additional federal estate taxes may become payable when the surviving spouse dies, please contact us so that we can review your particular situation.

Also, if you move to a state that imposes an estate or inheritance tax, you should have your estate plan reviewed by a lawyer in that state to see if it makes sense to modify your estate plan to minimize the state estate taxes. (If you move to another state, even if that state doesn't impose an estate tax or inheritance tax, you should still have your estate plan reviewed by a lawyer in that state.) Generally, for a married couple, estate plans we have prepared are designed to minimize the federal estate taxes payable on each spouse's death. In some cases, maximizing the use of the federal estate tax exemption on the first spouse's death can result in another state's estate tax becoming payable on the first spouse's death.**XIII. Planning for a Continued Estate Tax.**We now consider it unlikely that the federal estate tax will be repealed in the near future (although it is possible that compromise efforts will drag into 2010). People with estates of over $3,500,000 for an individual, or $7,000,000 for a couple who have a properly planned estate, should consider taking steps to reduce the impact of estate taxes on the portion of their estate above that level.

These include setting up a series of Grantor Retained Annuity Trusts, or forming a Family Limited Partnership or LLC or a Qualified Personal Residence Trust. Basic estate planning opportunities, such as making annual gifts to family members (or trusts for their benefit), paying tuition for grandchildren, and paying medical expenses for family members, should also be utilized.

XIV. **Time to Review Your Estate Plan?**

We recommend that you review your estate plan at least every five years or so, to make sure that it still expresses your wishes. You may no longer be in contact with the persons you named as Executors, Trustees, Guardians, or Health Care Agents, and thus may want to change these designations. Other changes, such as births, deaths, marriages, divorces, or changes in the size or nature of your estate, may also make changes appropriate.

XV. **Hoffman, Sabban & Watenmaker Lawyers Honored.**

We are proud to note that seven of our firm's lawyers were named as "Southern California Super Lawyers" or as "Super Lawyer Rising Stars" in the field of Estate Planning and Trusts by Los Angeles Magazine. This designation is applied to the top 5% of lawyers in the field, based on surveys of other lawyers. Four of the firm's lawyers were also named in the book,"Best Lawyers in America". Lawyers in the firm continue to serve the legal profession in a variety of capacities. For example, firm lawyers serve as members of the planning committees for the University of Southern California Probate and Trust Conference and the UCLA-CEB Estate Planning Institute, and serve on the Executive Committees of the Los Angeles County Bar Association Tax Section, the California State Bar Trusts & Estates Section, the Beverly Hills Bar Association and on the Estate Planning, Trust and Probate Law Advisory Commission of the Board of Legal Specialization for the State Bar of California.