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

TAX EXCLUSION AMOUNTS

- The lifetime estate and gift tax exclusion for 2016 is $5,450,000 (an increase of $20,000).
- The lifetime generation-skipping transfer (GST) tax exemption is also $5,450,000 for 2016.
- Any amount over the above exemptions will still be taxed at 40%.
- A surviving spouse can use the unused portion of the deceased spouse's estate tax exemption. To preserve that unused exemption, a federal Estate Tax Return must be filed for the deceased spouse, even if not otherwise required. (Special rules apply when the surviving spouse remarries; please contact us for more details.)
- A surviving spouse's unused generation-skipping transfer tax exemption cannot be used by the surviving spouse.
- The gift tax annual exclusion in 2016 for each donor is still $14,000 per recipient ($28,000 if the donor's spouse joins in the gift).
- The gift tax annual exclusion in 2016 for a gift to a spouse who is not a U.S. citizen is $148,000. There is no limit on tax-free gifts to a U.S. citizen spouse.

NEW TRANSFER ON DEATH DEED

- Effective January 1, 2016, there is a new way to hold title to real property, by a "Transfer on Death Deed." On this deed, a beneficiary is named to receive the property upon the death of the owner. The Transfer on Death Deed must be recorded within 60 days of the date it is signed; it is not necessary to notify the beneficiary that he or she has been named on a Transfer on Death Deed.

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- Transferring property in this manner avoids probate. The beneficiary automatically owns the property after the death of the original owner, regardless of any provision in a Will or trust that provides otherwise. The beneficiary must record an affidavit showing the death of the original owner, with a death certificate attached.

- The owner can revoke a Transfer on Death Deed any time prior to death, and can designate a new beneficiary on a new Transfer on Death Deed. During the owner's lifetime, the named beneficiary has no rights to, or ownership interest in, the property.

- If the named beneficiary dies before the property owner, the Transfer on Death Deed is not effective, and title reverts to the status that existed prior to the execution of the Transfer on Death Deed.

- Co-beneficiaries can be named on a Transfer on Death Deed. They must receive equal interests in the property after the death of the owner, and if one of them dies before the owner, the remaining beneficiary receives 100% of the property.

- A General Assignment transferring all assets into a living trust does <u>not</u> affect property subject to a Transfer on Death Deed.

- There is a mandatory form of Transfer on Death Deed included in the new law. There is also a mandatory Revocation of Transfer on Death Deed form.

- This form of ownership might seem like an easy way to transfer property at your death without the need for a trust or probate proceeding. However, there is very little flexibility transferring property in this manner. For example, your named beneficiary could die before you, and then either you may forget to change the ownership of the property, or you may lose capacity by that time. The title reverts to what it was prior to the execution of the Transfer on Death Deed, which might not be what you want. Also, questions can arise regarding how to allocate death taxes if some assets pass under such a deed. We recommend that you hold title to your real property in your living trust which provides more options, such as naming alternate beneficiaries and continuing to hold the property in the trust under the control of a responsible Trustee.

<u>NEW RIGHT TO DIE LAW</u>

- On October 5, 2015, Governor Brown signed into law California's "End of Life Option Act" (commonly called the "right to die" law), making California the fifth state to legalize physician-assisted death for the terminally ill. The other states are Oregon, Washington, Vermont and Montana.

- The effective date of the law has not been determined; it could be any time between now and November 2016. The law is effective only through January 1, 2026, unless it is extended before then. An effort by the group Seniors Against Suicide to block the new law has failed, but they are still threatening to file a lawsuit.

- The law allows a physician to prescribe an "aid-in-dying drug" to be self-administered by a terminally ill patient to bring about his or her own death if several specific requirements are met. A Health Care Agent under an Advance Health Care Directive cannot act to assist in the patient's death, regardless of any instructions made in the Directive.

- The patient must be at least 18 years old, a California resident and suffering from a terminal disease, and must have the mental capacity to make a voluntary and informed decision. A terminal disease is one that has been medically confirmed as incurable and irreversible, and that will result in death within six months (in reasonable medical judgment).

- The patient must initiate a request to the patient's physician for the drug by making two oral requests, at least 15 days apart, followed by a written, witnessed request. The doctor must then refer the patient to a consulting physician to confirm the diagnosis, prognosis and patient's mental capacity. Also, the patient must complete a "Final Attestation" form within 48 hours before taking the drug.

- Others may assist in preparing the drug and may be present when the patient ingests it, but no one may help the patient ingest the drug. The patient must do that alone.

- Death under the Act is not suicide for purposes of insurance coverage.

REPORTING BASIS OF ASSETS AFTER DEATH TO IRS AND BENEFICIARIES

- A new law imposes reporting requirements on trustees and executors with regard to the value of assets received by a beneficiary from a decedent's gross estate.

- Each person required to file an estate tax return must deliver both to the IRS and to each beneficiary a statement of the basis in each asset reported on the estate tax return.

- The information must be delivered no later than the earlier of 30 days after the date on which the return was required to be filed or 30 days after the date the return is filed.

- The IRS may grant a reasonable extension of time for filing the required report. A penalty is imposed for failing to file the form.

- A beneficiary may also be liable for a penalty if he or she later overstates the asset's basis on an income tax return.

- The current due date for filing such a report has been delayed to February 29, 2016, since the IRS has not yet issued forms and filing instructions. The new rule applies to all estate tax returns filed after July 31, 2015.

NEW TAX LAWS ELIMINATE CERTAIN SOCIAL SECURITY OPTIONS

- Three popular Social Security strategies will be eliminated as of April 30, 2016, but there is still a window of opportunity if you attain age 66 by that date, if you take prompt action.

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- "File and Suspend" is a strategy that permits you ("worker"), if you are age 66 or older, to claim a Social Security retirement benefit and then immediately suspend the claim (that is, you don't actually begin to receive money from Social Security). By suspending, you allow your own benefit to grow by accruing delayed retirement credits that increase your benefit until age 70 (at the rate of two-thirds percent per month for each month payment is delayed).

- The reason for using the "file and suspend" strategy is related to a second strategy that is also being eliminated. If you file (whether or not you suspend), your spouse (if age 62 or older), minor child, or disabled adult child, can claim a benefit on your account. Under the "restricted application" rule, if your spouse is at least age 66 and has an independent work record with Social Security, your spouse can later stop taking spousal benefits and switch to his or her own work benefit, which would also continue to grow. This "restricted application" rule is also set to be eliminated. Under the new rules, your spouse's own work benefit will no longer increase once he or she claims a spousal benefit. However, this change will not affect a spouse who attained age 62 prior to 2016.

- A third benefit (that is also being eliminated) allows a worker who exercises the "file and suspend" strategy to retroactively collect, at a later date, all of the benefits that would have been paid during the period that the benefits were suspended. Thus, if you suspend benefits at age 66 and then need the money before age 70, and if the benefit you would start receiving at that time is less than you would receive after age 70, you could receive, in a lump sum, the total amount of the benefits that were suspended. This approach was often used by single people with no children as an "insurance policy" in case of a major illness. This "retroactive lump sum" rule is now being eliminated. Instead, if you "unsuspend" benefits, you will receive the increased benefit, but not the lump sum.

- As noted above, if you will attain age 66 by April 29, 2016, you can still take advantage of the "file and suspend" strategy by filing for benefits before that date. For anyone else, it generally pays to defer the commencement of benefits until age 70, unless you think you're likely to die before age 83. For individuals who think they're likely to die before age 83, it generally makes the most sense to start taking benefits at age 66, and in some cases, at age 62.

IRA CHARITABLE ROLLOVERS ARE NOW PERMANENT

- On December 18, 2015, the President signed the Protecting Americans from Tax Hikes Act of 2015 (PATH), which extended several tax provisions, and made a number of temporary tax laws permanent. One provision that has been made permanent is the ability for IRA owners age 70½ or older to make a donation to one or more qualified charities directly from an IRA account, up to $100,000 per year.

- The donations count as part of the IRA owner's required annual withdrawal, and are excluded from income.

- The donation must be distributed directly from an IRA custodian to the designated charity. Some charities cannot receive these funds, including most non-operating private foundations (there is a

special exception for such foundations that elect "conduit" treatment), donor advised funds of community foundations, or supporting organizations.

- Other types of retirement accounts do not qualify for the charitable rollover benefit: 403(b) plans, 401(k) plans, pension or profit sharing plans, SIMPLE IRAs and SEPs.

- Donations made through a charitable rollover from an IRA do not count toward the limit on charitable deductions of 50% of adjusted gross income.

- By making a charitable rollover from an IRA instead of taking a required annual withdrawal, you reduce your "adjusted gross income." This has numerous implications (some good, some bad) on your taxable income if you itemize deductions. Also, if you do not itemize deductions, you can still benefit from making a charitable rollover from an IRA because the distribution is excluded from income.

TAX CREDITS FOR TUITION AND RELATED EXPENSES ARE NOW PERMANENT

Another temporary tax rule that has now been made permanent is the American Opportunity Tax Credit, which allows a tax credit of $2,500 for certain tuition and related expenses for the first four years of post-secondary education. This credit phases out for taxpayers with adjusted gross income starting at $80,000 for single taxpayers and $160,000 for married taxpayers.

TITLE INSURANCE MAY NOT COVER PROPERTY TRANSFERRED TO YOUR TRUST

- If you transferred your home or other real estate to your trust, your title insurer could deny coverage on the ground that the original owner (you) no longer owns the property. A policy of title insurance is routinely acquired through escrow when you purchase property.

- Title insurance protects you from things like undiscovered liens, easements and boundary disputes with neighbors. In 2009, in the case of *Kwok v. Transnation Title Insurance Co.*, a California appellate court sided with a title insurance company that denied a homeowner coverage in a dispute with a neighbor, because the homeowners originally took title in an LLC and later transferred the property to a living trust. Since then, insurance companies have denied coverage when property is transferred from individual owners to their living trust.

- Most homeowner's title insurance policies issued since 1998 have been CLTA and ALTA (American Land Title Association) policies, which do extend coverage to the trustee of a trust created by the same individuals who originally acquired the property, as well as the beneficiaries who inherit the property. This is the default policy named in the California Association of Realtors Residential Purchase Contract.

- You might want to find your title insurance policy and check to see if you are covered as trustee of your trust. If you do not have a CLTA or ALTA policy that was issued after 1998, you might not be covered. You can ask your title insurance company to check this for you, or you can call us to help you determine whether you are covered.

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- If your policy does not extend coverage to the trustee of your trust, you can ask your title insurance company for an endorsement to extend the coverage. There might be a small fee for the endorsement, such as $100.

LIFETIME GIFTS; PROS AND CONS

- For 2016, the lifetime gift tax exemption has been increased by $20,000. You can gift this amount in 2016 without paying a gift tax, even if you previously used all of your lifetime gift tax exemption (previously $5,430,000).

- The recipient of your gift will receive all future income and appreciation gift-tax free.

- One downside to making a lifetime gift is that the recipient receives your income tax basis in the gifted asset, which is how capital gains would be measured if the gifted asset is sold by the recipient. If, instead, you hold the asset until death, its basis would be adjusted to fair market value as of the date of your death.

- If you make gifts in excess of the gift tax exemption and pay gift tax, there is still an overall benefit versus holding the assets until death, assuming you live at least three years after the gift, because the cash you use to pay gift taxes is not in your taxable estate where it would be taxed. Taking this into consideration, the effective tax rate on lifetime taxable gifts is 28.6%, as opposed to a 40% estate tax rate.

- The President continues to express his desire to eliminate fractional interest discounts for gift or estate tax purposes for transfers between family members. It might make sense to make gifts of partial interests in family-controlled business and real estate interests now, while these discounts are available.

NO PARENT-CHILD PROPERTY TAX EXCLUSION FOR PROPERTY IN AN ENTITY

If you hold real estate in an entity, such as an LLC, partnership or corporation, the rules for reassessment of the property for California property tax purposes are more complex than the rules for individual ownership. Lack of planning can result in an unexpected increase in property tax.

- If the entity purchased the real estate, originally taking title in the name of the entity, the property will be reassessed when one person (or one other entity) obtains more than a 50% interest in the entity that holds title (a "control" test). The entire property is reassessed, even if only a small interest in the entity changes hands (e.g., a 49% LLC member acquires another 2%, giving her a 51% interest in the LLC).

- If co-owners originally own real estate and subsequently transfer it into an entity, reassessment may be avoided by claiming an exemption available when the co-owners hold the same proportionate ownership interests in the entity that they had in the real property. However, if the co-owners claimed that exemption, in the future the property will be reassessed when more than 50% of the interests of the original co-owners changes hands, regardless of whether any one person holds more than a 50% interest in the entity. In addition, the "control" test mentioned

above applies. For example, if there were originally three equal individual co-owners, 100% of the property will be reassessed when <u>either</u> (1) two of the co-owners die and leave their interests to their respective heirs (because more than 50% of the original ownership interests has changed hands), <u>or</u> (2) one of the original three co-owners transfers his interest to one of the other original co-owners (because one co-owner now holds two thirds, which is more than 50%).

- Although transfers of real property between parents and children (and in some cases between grandparents and grandchildren) qualify for a limited exemption from reassessment, there is no such exemption for transfers of interests in an entity holding real property.

- If your family members hold interests in an entity that owns real estate, you should consider taking the property out of the entity to qualify for the parent-child exclusion upon the death of an owner. Of course, this may eliminate the benefit of limited liability (which an LLC, limited partnership or corporation offers), so consider whether insurance coverage is sufficient to protect from liability.

- If you take property out of an entity before a death to use the parent-child exclusion from reassessment, and then transfer the property back into an entity, the Assessor may disregard the series of transactions and reassess the property anyway (applying the "step transaction" doctrine).

MAKE SURE TITLE TO PROPERTY IS IN YOUR TRUST, *E.G.* AFTER REFINANCING

- It is important that your real property (as well as all other assets of significant value) be held in the name of your trust, to avoid a court proceeding after your death.

- If you have refinanced your property recently, it is likely that the lender required that you take title out of your trust and into your individual name. The lender would not likely remind you to change title back into your trust. Please contact us if you would like us to check title to your property, or prepare a deed for you to transfer your title into your trust.

DIGITAL ASSETS

- Digital assets continue to increase their importance in our lives. These include on-line photo albums, email accounts, and social media accounts. Many people have on-line access to bank and securities accounts, or arrange for online automatic billing and payment of expenses (including utility bills and charitable contributions.) When planning your estate, remember to consider whether you want to leave someone the ability to access your digital accounts, and whether you have valuable assets accessible only through the internet.

PLANNING TO SAVE ESTATE TAXES

Current low interest rates make this a great time for wealthy individuals to set up a Grantor Retained Annuity Trust (a "GRAT"), or make term loans to family members (or sell to a trust for family members in exchange for a long term note) at the IRS minimum required interest rate, or if you also want to benefit charity, set up a charitable lead trust.

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FIRM RECOGNITIONS

We are pleased to have been recognized for the quality of our work by the following:

- *U.S. News - Best Lawyers* - Our firm received a Tier One (highest) ranking in its 2016 Edition of "Best Law Firms" for:
  Metropolitan - Litigation - Trusts & Estates
  Tax Law
  Trusts & Estates Law

- Paul Gordon Hoffman, Alan S. Watenmaker, Geraldine A. Wyle, Erin L. Prouty, Chang Chae, and Kenneth S. Wolf * are Fellows of the American College of Trust and Estate Council (ACTEC).

- *Los Angeles Magazine* listed Paul Gordon Hoffman, Alan S. Watenmaker, Geraldine A.Wyle, Jeryll S. Cohen, Erin L. Prouty, Chang Chae, Mary Ramsden, Danielle E. Miller and Kenneth S. Wolf * as "*Super Lawyers*" for 2015.

- The following attorneys have been selected for inclusion in the 2015 edition of *Best Lawyers in America*:
  - Paul Gordon Hoffman, Alan S. Watenmaker, Kenneth S. Wolf *, Jeryll S. Cohen, Erin L. Prouty, and Danielle E. Miller - *Trusts and Estates*
  - Paul Gordon Hoffman - *Tax Law*
  - Geraldine A. Wyle, Kenneth S. Wolf, and Jeryll S. Cohen - *Litigation: Trusts and Estates*

We would be happy to discuss with you the best options for taking advantage of any of the opportunities described above. If you are interested in discussing these opportunities or in reviewing your estate plan to ensure that it meets your current objectives, please contact us.

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