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HALES & GEORGE

ATTORNEYS AT LAW

N E W S L E T T E R

Devoted to Estate and Business Planning Law and Trust Administration Since 1972

FEDERAL ESTATE TAX LAW IS CHANGED

(BUT ONLY FOR TWO YEARS)

As astounding as it may seem, Congress and the President actually cooperated long enough at the beginning of the year to pass new legislation regarding the federal estate tax. The Tax Relief, Unemployment Reauthorization and Job Creation Act of 2010 made significant, but temporary, changes to tax laws including estate and gift tax law.

Before we discuss the changes, let's review a little history. The federal estate tax (also referred to as the "death tax" or "inheritance tax") was introduced in 1916 which coincides with America's involvement in World War I. Much of the current controversy has centered around a major tax reform law signed by President Bush in 2001 which reduced estate taxes over eight years until by 2009 only estates worth more than three million, five hundred thousand dollars ($3,500,000) or seven million dollars ($7,000,000) for married couples, were taxed at forty-five percent (45%). Then in 2010, the law repealed the tax entirely and prior to the new legislation, after December 31, 2010, only one million dollars ($1,000,000) of an estate or two million dollars ($2,000,000) for married couples, was exempt from estate tax with a maximum tax bracket of fifty-five percent (55%).

During the January 20ll "lame duck" congressional session, <u>new estate and gift tax laws were enacted for 2011 and 2012</u> which exempt from federal estate and gift tax five million dollars ($5,000,000) per person or ten million dollars ($10,000,000) for a married couple. Any amount in excess of this amount will be taxed at a rate of thirty-five percent (35%). The law also provides for the "portability" of any unused exemption. "Portabilty" allows the Executor or Trustee of a deceased spouse's estate to transfer the deceased spouse's unused five million dollar ($5,000,000) exemption to the surviving spouse. To do this, the Executor or Trustee must file an estate tax return for the deceased spouse and make the election, even if no estate tax return would otherwise be required. If the surviving spouse remarries however, the surviving spouse will lose the benefit of the election. **Importantly, <u>after December 31, 2012 the new law sunsets</u> and unless Congress again changes the law, the amount that passes free of gift and estate taxes will revert to one million dollars ($1,000,000) with a fifty-five percent (55%) maximum tax rate.**

Will Congress change the law again before 2012? Who knows? During the months preceding the 2008 election, then Senator Obama was against full repeal of the federal estate tax and instead favored a three million, five hundred thousand dollar ($3,500,000) exemption and forty-five percent (45%) tax rate. For the sake of comparison, John McCain favored a five million dollar ($5,000,000) exemption and a fifteen percent (15%) tax rate. Prior to the enaction of the new law, House Democrats strongly voiced their opposition to the significant bump in the federal estate tax exemption and decrease in the estate tax rate and tried to pass a bill that would have reinstated the 2009 exemption and tax rate.

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<u>OTHER REASONS TO MEET WITH HALES & GEORGE</u>

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DO YOU NEED TO CHANGE YOUR ESTATE PLAN

We continue to stress that Living Trusts are a necessary and important vehicle in estate planning and <u>your Trust should be reviewed with us to confirm whether any updates are necessary because of the 2011 tax law changes.</u> Living Trusts are important for the following reasons:

1. **No Probate.** People dying with no estate plan or with Wills are subject to the

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What will happen during the next few years? At least four (4) different options exist for Congress to take:

1. The first option is for Congress to do nothing and allow the new law to sunset as it is scheduled to do on December 31, 2012. If this happens, then a one million dollar ($1,000,000) estate tax exemption and fifty-five percent (55%) estate tax rate will start on January 1, 2013.

2. The second option is for Congress to extend the 2011 and 2012 law in 2013 and beyond. This would keep the estate tax exemption at five million dollars $5,000,000 and the estate tax rate would remain at thirty-five percent (35%).

3. The third option is for Congress to pass some form of an estate tax compromise which will lower the estate tax exemption and increase the estate tax rate to something more in line with the 2009 numbers of an exemption of three million five hundred thousand dollars ($3,500,000) and a tax rate at forty-five percent (45%). This may also include the repeal of the portability of the exemption between spouses which is in effect for 2011 and 2012.

4. The fourth option is for Congress to completely repeal the federal estate tax. This is possible because currently Republicans are in control of the House and have gained significant numbers in the Senate and a substantial number of congressional Republicans favor full repeal of the estate tax.

Regardless of what Congress does in the future, ***we encourage our clients to make an appointment to visit with us and review how the current changes in the estate and gift tax law effect the planning that you have done.*** Additional reasons to meet with us are contained in this Newsletter but the changes in the law are good reasons to see us to discuss how they impact your estate plan and what updates may be necessary.

DO YOU NEED TO CHANGE YOUR ESTATE PLAN?

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Probate Court with its exorbitant costs (up to five percent (5%) of the gross value of the entire estate) and time consuming legalities (even simple Probate can require several years to complete). Living Trusts avoid Probate.

2. **Guarantee Tax Exemption.** At the first death of a married couple, the provisions of our Living Trusts typically allocate the tax exempt portion of the deceased spouse's assets into a Family or Bypass Trust. These assets, and **their appreciation** are estate tax free at the second spouse's death when the assets are administered for the next generation. Regardless of the tax law changes after 2012 and the possible repeal of the "portability" of the deceased spouse's exemption, the Living Trust guarantees that all tax exemptions are utilized at death.

3. **You Know Who Will Inherit Your Estate.** Our clients with Living Trusts know that their assets will be distributed to the beneficiaries they choose. At the first death, the surviving spouse's assets are allocated to a "Survivor's Trust" and that spouse "owns" those assets, i.e., can do anything they wish. The deceased spouse's tax free assets are allocated to a Family Trust which are available for the surviving spouse's "use". This "use" allows the surviving spouse to be the Trustee (manager) of all assets, to receive all income and the principal for their necessities (health, education, food, clothing, housing and transportation) and to receive from principal five percent (5%) per year for any reason. At the death of the surviving spouse, the Survivor's Trust is distributed according to the surviving spouse's wishes. However, the balance of the Family Trust must be distributed according to the deceased spouse's wishes. Alternatively, with a Will, the first to die never knows to whom their assets will be distributed because at the first death, the surviving spouse "owns" all of the assets and may distribute those assets to anyone at their death (including their next spouse and their children).

4. **Assets Are Managed for Children.** At the parents' death, Living Trusts appoint Trustees to manage and distribute assets. Often at the second death, the assets are held in trust and distributed for the necessities of the children at the discretion of the Trustee. The assets are then distributed when the children have attained mature ages or sometimes not until the childrens' death. Remember, while assets are in trust, children cannot lose the assets to divorcing spouses or creditors. When people die with no estate plan or with a Will and no trust exists, the Probate Court distributes assets to children when they attain age eighteen (18) and if they are minors, an additional and expensive court procedure is necessary for a judge to pick a person/guardian to manage the estate (and the children) until the children attain age eighteen (18).

OTHER REASONS TO MEET WITH HALES & GEORGE

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Update Exhibit A's

Your Exhibit A **must be kept current** because it lists the assets that are in your Living Trust. Remember, the original Exhibit A was returned to you with your other original estate planning documents and **you must add and delete assets** as appropriate. If you own real property, you must add the real property on your Exhibit A and you must have a Deed transferring the property into the Living Trust. **Please call us for a meeting to review your assets and Exhibit A and ensure that all is curent.**

Review Beneficiary Designations

Assets like life insurance, 401k's, IRA's, etc. have beneficiary designations which you must complete. The beneficiary designation mandates who the beneficiary is when you die. If you want your Trust to be the beneficiary of these type of assets, the beneficiary designation must list the Trust, i.e., ***the mere listing of these assets on the Exhibit A does not designate your Trust as the beneficiary.*** The beneficiaries you designate on your IRA's and retirement plans have very serious implications for income taxation and estate planning at your death. **It is imperative that you understand the tax ramifications of who your beneficiary is and please make an appointment to discuss this with us if you are unsure.**

Changes in Capital Gains Tax Laws

Generally, capital gains tax is paid when an asset is sold on its profit, i.e., the difference between the basis of an asset and its fair market value (FMV). However, when someone dies, some of their assets receive a "stepped-up" basis to the asset's FMV. Capital gains tax laws for 2011 and 2012 have changed and become too complicated to adequately discuss in this short Newsletter. However, **important changes in the capital gains tax law have been made for 2011 and 2012. Please call our office to arrange a meeting if you would like to discuss your options regarding capital gains tax.**

Children Need Durable Powers of Attorney and Advance Health Care Directives

When children attain age eighteen (18), their parents no longer have any power to make decisions for them, even if the children are incapacitated. Therefore, if parents want to act on behalf of their adult children (yes, they are adults if they are 18), the children must execute a Durable Power of Attorney for legal decisions and an Advance Health Care Directive for health care decisions, naming their parents as their agents. Of course, all adults should also have these documents and a wallet card to prevent a time consuming and expensive conservatorship proceeding. Please call us if you would like us to prepare these documents.

Protect Investments with a Limited Liability Company (LLC)

Many of our clients are placing their businesses or rental properties into LLC's to shelter liability. For example, if a problem occurs in your business or rental property and you are sued and lose, all of your assets could be lost without the protection of a LLC. If your business or properties are in a LLC and you lose in a law suit, the only assets subject to the law-suit are the assets in the LLC, not your total estate.

Changes Regarding Children and/or Grandchildren

Children born to you after the execution of your estate plan must be added to your documents. Also, if children are now adults, you may wish to change the distribution of your assets to the children or you may want to consider the children as Successor Trustees. Additionally, with the birth of new grandchildren, many of our clients consider a bequest of a percentage of their assets to their grandchildren, for example, for their education.

Death of a Spouse, Trustee or Beneficiary

If your spouse has died since you both created your Living Trust, you should contact our office. At the death of a spouse, a process called Trust Administration is necessary to administer your Living Trust and take full tax advantage of the laws. Please call us if a death has occurred because we initially planned your estate and we know best how to administer it after a death. Additionally, if a Trustee or a beneficiary of your trust is deceased, we should discuss replacements and the distribution of your estate.

Miscellaneous Reasons:

-Marriage or Remarriage
-Separation/Divorce
-Children with drug/alcohol problems
-Children with special needs
-Review Overall Estate Plan

HALES & GEORGE WEBSITE AND E-MAIL ADDRESS

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HALES & GEORGE, a family-owned law firm with offices in Saratoga and San Francisco, California, specializes in Estate and Business Planning as well as Probate and Trust Administration. Each partner of Hales & George is a member of the State Bar of California, the Santa Clara Bar Association, and the Silicon Valley Bar Association. This issue of the Hales & George Newsletter was written & edited by attorneys William P. George and Jan Marie Hales. Any questions raised by these articles can be addressed by simply writing the law firm at 19040 Cox Avenue, Suite 3, Saratoga, CA 95070 attention: H&G Newsletter. This newsletter is intended to be a source of information for our clients and associates and should not be considered personal legal advice. Laws can change frequently and rapidly. Please consult your attorney before relying on any information contained in this publication. (408) 255-6292, Fax - (408) 865-1904, e-mail: postmaster@halesgeorge.com

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Estate Plan Up-Date Certificate

As a service to our existing clients who have received this NEWSLETTER, this certificate entitles you to a meeting with an attorney from HALES & GEORGE to review your estate plan and the impact of current tax laws for a fee of $250. This meeting will be a review of all your estate planning documents including your Exhibit "A". If any additional documents or changes to existing documents are required, an additional fee will be quoted during your scheduled appointment.

Please complete the information below and return this certificate with a check for $250 payable to HALES & GEORGE. Upon receipt, we will contact you to arrange a convenient time to meet with you or please feel free to call us at (408) 255-6292 to schedule an appointment.

NAME:_____

ADDRESS:_____

DAYTIME OR CELL PHONE:_____ HOME PHONE:_____

EMAIL ADDRESS:_____