Hoge Fenton's
estate planning newsletter

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"True, I can't take it with me, but I can take the access codes to it."

Major Tax Changes

At last, we have something to tell you about the estate tax. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 enacted on December 17, 2010 (the "Tax Act") makes major changes to the estate, gift and generation skipping transfer taxes. Those changes will affect the taxation of gifts made during your lifetime and transfers made at your death. The changes are effective only through 2012 when Congress will have to decide whether to extend the changes or change the law again.

estate tax. The estate tax exemption (the amount that can be transferred by a person at death free of estate tax) increases to $5 million. If the value of a person's estate at death is more than $5 million, the excess value is taxed at a maximum tax rate of 35%. Contrast that with the 45% top rate in effect in 2009 for estates worth more than $3.5 million.

portability of estate tax exemption. The executor or trustee of the estate of a married person who dies in 2011 or 2012 with an estate valued at less than $5 million may elect to grant the deceased spouse's unused estate tax exemption to the surviving spouse. The surviving spouse's estate could use the deceased spouse's unused exemption as well as his or her own estate tax exemption to reduce or eliminate estate tax at the death of the surviving spouse.

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Should couples simplify their estate plans given the increased exemptions?

We recommend that any changes be made cautiously given the fact that the changes made by the Tax Act are effective for only two years.

A married couple whose total estate is valued at less than $5 million might consider simplifying their plan by eliminating the required division of the trust between the Family Trust (also known as the credit or bypass trust) and the Survivor's Trust after the first spouse dies. Instead, the trust could direct that all of the assets be allocated to the Survivor's Trust, which the surviving spouse could use without restriction and could amend or revoke during his or her lifetime. If the value of the trust was less than $5 million at the surviving spouse's death and the estate tax exemption remained at $5 million, no estate tax would be payable. And, if the value of the trust had increased to more than $5 million and the trustee of the trust had elected at the first spouse's death to transfer that spouse's unused estate tax exemption to the survivor, the combined exemptions might be sufficient to eliminate payment of any estate tax.

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A variation on the plan to eliminate the Family Trust would be to eliminate the required division of the trust, provide for the entire trust to be allocated to the Survivor's Trust, but give the surviving spouse the option, after the death of the first spouse, of disclaiming (or redirecting) all or a portion of the deceased spouse's share of the trust into an irrevocable trust (like the Family Trust). The amount not disclaimed, including the surviving spouse's share of the trust, would be held in the Survivor's Trust. The Family Trust would be taxable, but the estate tax would be "paid" by using some or all of the deceased spouse's estate exemption. The Family Trust would be distributed at the second death as the spouses had agreed and would not be subject to further estate tax in the surviving spouse's estate. This is a flexible plan that allows the surviving spouse to look at the value of the trust and the estate tax law in effect at the death of the first spouse and make an informed decision whether to use some or all of that spouse's exemption at the first death. While this plan adds some flexibility to deal with changes in the tax law, the surviving spouse would still control how the trust will be administered after the death of first spouse.

When considering whether to simplify the estate plan in either of those ways, a couple must recognize that the surviving spouse will have the power to change how the entire trust will be distributed at his or her death, perhaps disregarding the plan of distribution originally agreed upon by the spouses when both were living. In the "disclaimer" plan, the decisions whether to disclaim rests entirely with the surviving spouse. These plans may not be suitable for a husband and wife who have children from prior marriages, for example.

We recommend that a married couple whose estate is worth more than $10 million retain the required division between the Family Trust and the Survivor's Trust. Some trusts require division into three trusts: Family, Marital and Survivor's Trusts. In most cases, if the value of the trust at the first death were less than $10 million, the Marital Trust would not be created. If the value of the trust at the first death were more than $10 million, you might want to revise the trust agreement to specify that a Marital Trust would be created only if the amount that would be allocated to that trust exceeded a specific dollar amount in order to avoid the expense of administering a small trust.

gift tax.

The Tax Act increased the gift tax exemption from $1 million to $5 million for gifts made in 2011 and 2012 and set the maximum tax rate on gifts in excess of $5 million at 35%. This change presents opportunities for a person who has already used his $1 million gift tax exemption to transfer an additional $4 million out of his estate during the next two years without actually paying any gift tax. The estate and gift tax exemptions are now unified. In effect, that means if you use your entire $5 million gift tax exemption to avoid gift tax during your lifetime, your estate will not have a $5 million estate tax exemption to use at your death.

Given the uncertainty about the estate and gift tax law after 2012, individuals with substantial estates may want to take advantage of the increased gift tax exemption by making substantial gifts to children and grandchildren before 2013. Transferring an asset during your lifetime shifts the value of the asset, the post-transfer appreciation on the asset, and income earned by the asset from you to the recipient. Making gifts in the current economic climate is especially attractive, given depressed asset values. We would be glad to talk with you about ways to make good use of the increased gift tax exemption. There are indications from Congress that the benefits of some of the gifting strategies we have recommended in the past, such as forming family partnerships or limited liability companies and transferring interests in those companies to children and establishing grantor retained annuity trusts, may be curtailed or eliminated by future tax legislation. Thus, making gifts of assets likely to appreciate and using other tax-effective techniques while they are still available, is worth considering.

loans to family members.

Given the current tight lending market, it is not unusual for parents to consider making loans to children, often to help them purchase a residence. Such loans must be carefully structured to avoid income and gift tax issues. Generally, if interest charged on an intra-family loan is equal to or more than the current "applicable federal rates" set by the Treasury Secretary for certain loans made to family members, the lender has not made a gift of "foregone interest." In the case of a loan to a child to purchase a residence, consider whether to secure the loan with a deed of trust on the residence. Also, consider whether to amend your estate plan to provide that outstanding loans made to children during your lifetime are to be allocated to a child's share of the trust, or forgiven, or whether some other adjustment to the distribution of the trust should be made to equalize the shares of the children.

In another increasingly common intra-family loan situation, a younger family member who needs cash borrows from an elderly family member. If the borrower pays interest at a rate higher than the elder was earning on that cash, the elder lender benefits. And, if the interest rate payable by the borrower is less than the rate that the borrower would have paid to a commercial lender, the younger borrower benefits. Or, suppose an elder is struggling to pay her monthly living costs, including a mortgage payment. A younger family member with available cash might pay off that mortgage and make a new secured loan to the elder at more affordable interest rates. The elder reduces her living costs, and the younger family member is able to assist the elder and secure repayment of his investment.

generation skipping transfer tax.

In the gift tax discussion, we mention lifetime gifts to grandchildren. Such transfers involve not only the gift tax but also the generation skipping transfer tax (GST tax). That tax is imposed in addition to the gift and estate tax on transfers you make that skip a generation. The simplest skip transfer is an outright gift made by a grandparent to a grandchild. Another kind of generation skipping transfer is one by a parent to a trust for the lifetime benefit of that parent's child, with the trust remainder passing to the child's child (the transferor's grandchild) at the child's death. The tax advantage of the latter transfer is that the child benefits from the trust during his lifetime, but the trust is not part of his taxable estate at his death.

The GST tax exemption for 2011 and 2012 has also been increased to $5 million, making transfers to or for the benefit of grandchildren attractive during those years. The top tax rate for generation skipping transfers in excess of $5 million made in those years is 35%.

Non-Tax Planning Issues

Given the estate tax changes, the focus of many of our clients' estate planning will turn from estate tax avoidance to how the trust will be administered for the various beneficiaries. It is a good idea to look at the terms of trusts established at the death of one spouse for the benefit of the surviving spouse and the terms of trusts to be established for children and grandchildren. Also, look at your choices for executor, trustee, guardian and agent under powers of attorney for health care and finances.

beneficiary designations.

Remember that retirement accounts and life insurance policies generally are not assets of your revocable trust or your probate estate. Those assets are distributed at death according to the beneficiary designation you make on a written form held by the retirement plan administrator or insurance company. It is important to check the beneficiary designations for your retirement accounts and life insurance policies periodically to be sure they are appropriate and, more important, tax-efficient. If you have questions about beneficiary designations, let us know.

the digital age.

As more and more banks and brokers encourage clients to go paperless with their statements and to manage their financial transactions online, it becomes more difficult for a person handling the affairs of an incapacitated person or administering a deceased person's estate to gather information about that person's assets and to handle transactions for him or her. To make it easier for someone to step into your shoes, we recommend that you make a list of your paperless asset accounts (banks, brokerages, etc.) and keep that list securely stored with your other financial records. We recommend that you also tell the person named as agent under your financial power of attorney or your successor trustee where you store your internet passwords and other information needed to access your accounts. If you are tech savvy, you may already keep a spreadsheet with that information on your own computer or use a website or smart-phone app designed to store and make available online information. If you do store that information on your computer or an online service, keep in mind that someone must have the password to access your computer or the storage service.

avoiding family feuds over grandma's yellow pie plate.

We handle a lot of post-death legal work, advising trustees about administering trusts, assisting executors in probate matters, and litigating disputes among trustees and beneficiaries. Disputes among beneficiaries over the division of a deceased person's tangible personal property (furniture and furnishings, jewelry, cars, artwork, etc.) can become very heated and emotional. You may be able to minimize those disputes by talking with family members now about your wishes and their preferences, beginning to distribute your tangible personal property while you are alive, and leaving written instructions about who should receive specific items after your death. Check out yellowpieplate.umn.edu, the University of Minnesota's guide to passing on personal possessions, for more suggestions.

"If Patrick Henry thought that taxation without representation was bad, he should see how bad it is with representation."

Farmer's Almanac

housekeeping tips. We are sometimes asked by clients if they can throw away their "old" estate planning documents. First, create a file or a binder in which you will keep only those estate planning documents currently in effect. Those would be the most recent version of the trust and any subsequent amendments, and the most recent Wills and any codicils made to those Wills. Any prior versions of the trust, amendments made before the most recent version of the trust, prior Wills, and codicils made to those Wills should be boxed up and marked "superseded." Why not dispose of them? If, after your death, a beneficiary were to file a contest of a trust or Will, the provisions of prior versions of that trust or Will could become relevant. So, keeping those superseded documents is a cautious approach.

You certainly may discard deeds and other documents for real properties you no longer own. If you established irrevocable trusts in the past that have been terminated, discard copies of those trusts. Do not keep copies of insurance policies that are no longer in effect.

For guidance on how long to keep other financial information, you may find these websites helpful:

- www.dcu.org/streetwise/howto/records.html
- www.bankrate.com/finance/personal-finance/how-long-to-keep-financial-records.aspx
- careonecredit.com/knowledge/financial-record-keeping.aspx

Meet Some of Our New Colleagues!

We are happy to announce that Robert J. Browning joined Hoge Fenton in late 2009. Rob is an experienced estate planning and taxation attorney who is based primarily in the firm's Silicon Valley office. He counsels clients in complex tax and wealth planning, estate planning, and trust administration matters. His practice is primarily focused on developing and implementing creative solutions for his high net worth clients' complex tax issues, including creating the structures necessary to effect their wealth planning objectives. Many of Rob's clients are multi-generational families with significant businesses with whom he has worked to create effective succession plans. Complex family dynamics often come into play in this area of practice. Older generations understand and appreciate Rob's high level of skill and experience, while younger generations find it easy to relate to him because he is a relatively young practitioner in the field. His broad tax knowledge and his effective communication skills allow him to provide his clients with guidance in areas besides estate planning, as well. Rob is a graduate of Georgetown University (LL.M., Taxation), Pepperdine University School of Law (J.D.), and the University of Utah (B.A.). He is licensed to practice in California, Washington State, and Washington, D.C.

Also joining Hoge Fenton in late 2009 is David S. Howard. A longtime Deloitte tax partner, and dual-licensed as a CPA and attorney for nearly 40 years, Dave recently returned to the practice of law. He is based primarily in the firm's Silicon Valley office. While at Deloitte, Dave developed tax strategies for large multinational corporations, Silicon Valley start-ups, family businesses, corporate executives, and wealthy individuals. He continues to provide these types of services to a select group of clients, and from his Hoge Fenton platform he can now offer them a broader range of service. Dave's specific areas of expertise include handling corporate and individual income tax controversies in all jurisdictions; untangling domestic and international tax strategies and compensation plans gone awry; assisting high net worth and high profile clients with sophisticated strategies to help them protect their wealth and minimize taxes on transfers; business succession planning, particularly for closely held and family owned companies; and acting as gatekeeper for his clients' teams of professional advisors to coordinate services and minimize duplication of efforts and cost. He is a graduate of University of Southern California's Gould School of Law (J.D.), University of Southern California's School of Policy, Planning and Development (M.P.A.), and University of Southern California's Marshall School of Business (B.S.). Dave is fluent in English and Spanish and is licensed to practice in California, U.S. District Court, and U.S. Tax Court.

We hope you have an opportunity to meet Rob and Dave soon. Should you have a question about anything contained in this newsletter, or any estate or tax-related issue, please feel free to contact any member of our Estates & Trusts and Taxation groups.

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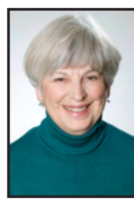

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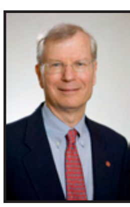

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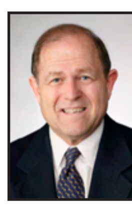

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