Life Planning Newsletter
The Law Offices of James A. Busse Jr.
Long Beach CA, Carson City NV.
December 2007

Merry Christmas from Finca Los Anonos

In this issue:

Our law firm focuses on Estate and Life Planning for those who wish to preserve their assets for their family. By doing Probate work for our clients we have established Estate Planning methods that are court tested. Because the goal of every person is to have peace of mind their wishes will be carried out, our integrated approach constantly tests the effectiveness of your Estate Plan with actual California and Nevada Cases. Our law firm integrates low cost Probate with coordinated Estate Planning documents to significantly reduce the impact of the State claim for nursing home care.

This newsletter is provided to our clients free of charge via e-mail and on line at www.jabusse,com

2010 a GIFT & ESTATE TAX Oddity

Q: Will gift taxes be repealed in 2010?
A: No. The tax on lifetime transfers of assets to family and friends will remain, but like the estate tax, rates will be reduced and the exemption raised.

The $12,000 annual exclusion will also remain in effect. This exclusion allows you to give $12,000 each year to as many individuals as you wish without incurring any gift taxes, or counting toward your exemption amount.

In 2002, the amount exempted from gift tax increased from $675,000 to $1 million, but unlike the estate tax exemption, this exemption did not increase further. Gift tax rates were reduced from the 2001 maximum rate of 55% to 45% in 2009, following the same schedule as the estate tax rates. In 2010, the gift tax rate will be the same as the highest individual tax rate, currently scheduled at 35%.

Example: Each year, beginning in 2002, Dave makes outright gifts (not in trust) of $112,000 to Mars and Jupiter, his two sons. The first $12,000 of each gift is free from gift taxes. The remaining $100,000 of each gift counts towards Dave's $1 million gift tax exemption. In 2007, the first $12,000 of each gift will still be excluded from gift taxes, but, because Dave will have used up his $1 million exemption (5 years x 2 gifts x $100,000 = $1 million), the remaining $100,000 of each gift will be subject to gift taxes.

Q: Should these changes affect my lifetime gifts to friends and family?
A: Possibly. While you may wish to give up to the $1 million maximum allowable amount, it may be best to stop there and consider other ways to distribute your assets. If the estate tax repeal becomes permanent, you will be better off transferring any additional assets at death, when the transfer will be Estate tax-free.

However, if you do wish to give over the $1 million limit, structuring the gift as part of a charitable donation, such as a charitable lead trust, may help lower your tax bill and provide help to a worthy cause.

Q: How may the 2010 changes to the "cost basis" of certain property affect my estate?
A: For income tax purposes, "basis" means the purchase price of property adjusted for various actions such as depreciation. If you own property and then sell it, the difference between the cost basis and your selling price minus costs is your "gain." This gain is subject to income tax.

Until 2010, those who inherit property are entitled to a "stepped up basis:" their income taxes on the eventual sale of inherited property are calculated based on the fair market value of

the property on the date of death of the person making the bequest rather than that person's original cost. When the inherited property is eventually sold, this stepped-up basis effectively reduces or eliminates the capital gain tax on the sale.

However, in 2010, the stepped-up basis is replaced by a "**carryover**" basis: the beneficiary inherits the **original** basis in the property. This provision may result in **significant tax** on the sale of inherited property that has greatly increased in equity. Two credits are allowed:
(1) For each estate, a cumulative increase in the basis of all property in the estate property by $1.3 million is permitted;
(2) For transfers to spouses, a $3 million increase (in addition to the primary $1.3 million) is permitted.

Example: Dave owns stock and 2 homes, each worth $4.5 million. He paid $1 million for the stock, and $750,000 each for the homes. Dave wishes to split these assets between his wife Venus and son Hal so he leaves the homes to Venus and the stock to Hal. The $3 million exemption for transfers to a spouse raises Venus's basis in the homes from $1.5 million to $4.5 million. The $1.3 million exemption increases Hal's basis in the stock from $1 million to $2.3 million. If Hal were to sell the stock immediately, he would have a taxable gain of $2.2 million, (taxed by the fed and state at a combined rate of up to 48%) offsetting some of the savings realized from the repeal of the estate tax.

Q: How might I minimize the taxable gain my heirs might encounter if I die in 2010?
A: It is best to leave assets that are subject to the most gain to your spouse first, to take advantage of the additional $3 million basis increase allowed when transferring property to spouses. Additionally, you can help avoid taxes by structuring a charitable gift. Gifts to charity made during your lifetime can provide substantial benefits to you and your heirs, including a healthy income stream, immediate tax savings, avoiding or delaying capital gains taxes, and the ability to shield assets from the claims of creditors.

Q: When the estate tax is repealed for 2010, will heirs face other taxes on inheritances?
A: Remember, the repeal is only in effect for 2010, and the 2001 Tax Act applies only to federal tax rates; California and Nevada do not have estate or inheritance taxes (taxes paid by the person inheriting) But if the heir lives in one of the ten states that do have inheritance taxes (Indiana, Iowa, Kansas, Kentucky, Maryland, Nebraska, New Jersey, Oregon, Pennsylvania and Tennessee) those taxes will still be in effect regardless of what the Fed does. In addition, assets like individual retirement accounts are still subject to deferred income taxes. Taxes are payable on these accounts at the time of use or transfer at inheritance -- although with proper planning these taxes can be deferred for many years.

Q: How can I reduce the effect of taxes on the retirement plan assets in my estate?
A: If you are already planning a bequest to charity, use your IRA retirement plan residue to do it. Your heirs will still receive the benefit of your charitable donation as a deduction against their inherited amount, and, because the retirement account funds are going to charity, the deferred income taxes are eliminated.

Similarly, funding a testamentary charitable gift annuity or charitable remainder trust with retirement plan residue rather than cash or property will also reduce your heirs' tax bill.

Life Estates and Proposition 13 tax increases.

The California Appeals Court has ruled the conveyance of a life estate was not a transfer "substantially equal to the value of the fee interest." (Rev. & Tax. Code, § 60.)[1] Therefore, there was no change in ownership for purposes of Proposition 13. This means that gifting or transferring a life estate to another does not change the Proposition 13 tax basis regardless of how long the life estate holder may live. Los Angeles County has appealed this ruling to the California Supreme Court. The case is Steinhart vs County of Los Angeles. If upheld by the Supreme Court, transferring Life Estates will become a very good way to transfer real property in an estate plan without increasing the property tax on the property while the transferee occupies the house.

The Law Offices of James A. Busse Jr.
3937 Elm Ave.
Long Beach, CA 90807
(562) 490-4905
trust@jabusse.com **www.jabusse.com**