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A PARTNERSHIP OF PROFESSIONAL LAW CORPORATIONS

NEWSLETTER

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2009 INCREASES IN THE APPLICABLE CREDIT AMOUNT AND ANNUAL GIFT EXCLUSION

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Since 2002, the Gift Tax Exemption has remained at \$1,000,000 while the Estate Tax Exemption has steadily risen. In 2009, individuals can gift up to \$1,000,000 during lifetime without paying a federal gift tax. This amount is unchanged from 2008. However, in 2009 the amount that can be gifted or transferred at death without paying a federal estate tax has increased from \$2,000,000 to \$3,500,000.

The "Applicable Credit Amount" is the federal tax credit that shelters these gifts from tax. For 2009, the Applicable Credit Amount for Estate Taxes is \$1,455,800; this credit effectively pays the tax on an estate of up to \$3,500,000. A married couple, with proper tax planning, can now shelter from estate tax a combined total of up to \$7,000,000 of assets owned by either spouse upon their deaths (less any lifetime gifts).

A married couple can also combine their lifetime Gift Tax Exemptions to gift up to \$2,000,000 of assets owned by either spouse during their lifetimes.

The Gift Tax Annual Exclusion Amount has also increased for 2009, rising from \$12,000 to \$13,000. Each taxpayer can now gift up to \$13,000 a year per donee free of gift tax. These annual gifts are significant because they can be

made without using any of the donor's lifetime Gift Tax Exemption. There is no limit to the number of these tax free annual gifts a donor can make, provided the donor gives no more than \$13,000 per year to any one individual. Like the lifetime Gift Tax Exemption, married persons can combine their gifting to transfer a total of \$26,000 per year per donee from the assets for either spouse. For example, where a husband has substantial separate property assets, the wife can agree to use her Gift Tax Annual Exclusion Amount to shelter from tax another \$13,000 gifted by her husband ("split gifts"). In addition, amounts paid directly to a school for a donee's tuition, or to a medical provider for a donee's care, are always free of gift tax.

Under the current law (Economic Growth and Tax Relief Reconciliation Act of 2001), the Estate Tax will disappear for 2010, however the tax will return in 2011 with an exemption of only \$1,000,000 (rather than the \$3,500,000 for 2009). The Gift Tax will remain unaffected.

However, tax experts agree Congress may not allow this to happen. Two bills addressing this issue have been introduced to the House. The first bill was introduced by Representative Earl Pomeroy (D - ND) on January 9, 2009. H.R. 436, known as the Certain Estate Tax Relief Act of 2009, seeks to permanently limit the Estate Tax Exemption at the current level (\$3,500,000) and would repeal the current carryover basis rules (which increase the tax basis in an asset owned at death to its current fair market value). If enacted by Congress, the new law would apply to the estates of individuals dying after December 31, 2009.

The second bill (H.R. 498) was introduced by Representative Harry E. Mitchell (D - AZ) on January 14, 2009 and also seeks to reform estate and gift taxes permanently. It includes staged increases in the Applicable Exclusion Amount to \$5,000,000, makes the gift tax lifetime exemption equal to the Applicable Exclusion Amount, set the top estate tax rate at the top capital gains tax rate for estates not over \$25 million and double the capital gains tax rate for estates over \$25 million, repeals the state death tax deduction, and makes the first spouse's unused Applicable Exclusion Amount available to the surviving spouse.

Both bills have been referred to the Committee on Ways and Means for consideration and possible changes.

Our firm will be keeping a close watch on this situation and note developments in future issues of this Newsletter.



HOLDING TITLE TO REAL PROPERTY

RAY W. RIDLON

There are many ways to hold title to real property. For example, property can be held in an individual's name, in the name of a trust, or in the name of a corporation, partnership or LLC.

How title is held or transferred can have significant consequences in terms of property taxes, income taxes, gift taxes, transferability, exposure to creditors, and probate. When purchasing or transferring real property, the property owner needs to be aware of the consequences of how title is to be held. If unsure of the consequences, the property owner should seek legal counsel.

The purpose of this article is to review the most common ways that title may be held in an individual's name, either as sole ownership or in co-ownership with others. A future article will describe the holding of title within a trust or in the name of a legal entity (i.e., corporation, partnership, LLC, etc.).

Sole Ownership: For single, married individuals,

and those individuals in a registered domestic partnership who are acquiring property as their sole and separate property, title is often recorded as described below in this section. At the death of an individual holding title in this manner, the property generally will need to pass through the expensive and time-consuming probate process before it can be transferred to the decedent's beneficiaries or heirs.

Single or Unmarried Persons: For individuals who are neither married nor in a registered domestic partnership, title as either "single man/woman" or "unmarried man/woman" may be used.

Historically, using "a single man or woman" (i.e., *Betty Smith, a single woman*) meant that the individual has never been married or in a registered domestic partnership, whereas "an unmarried man or woman" (i.e., *Sam Jones, an unmarried man*) meant that the individual was previously married.

A Married Man/Woman as His/Her Sole and Separate Property: This title is used when a married man or woman acquires property separately from his or her spouse (i.e., an inheritance, a purchase using separate-property funds, or a gift from the other spouse). An example of the vesting would be, "*Betty Smith, as her sole and separate property.*"

When property is acquired in this manner, or when such property is later sold or otherwise transferred, the title company may require the spouse of the property owner to quitclaim any right, title and/or interest s/he may have in the property to ensure that the non-owner spouse has no ownership claims against the property.

A Registered Domestic Partner as His/Her Sole and Separate Property: Similar to the situation for an "Unmarried Man or Woman", this title is used to clarify that a registered domestic partner has acquired property and the other partner has no right, title and/or interest in such property. The vesting may read, "Sam Jones, a registered domestic partner, as his sole and separate property."

Co-Ownership: When an individual holds title to property in co-ownership with other individuals or entities, the vesting may be in the following forms:

Community Property: This title may be used by married couples or registered domestic partners. In California, real property acquired by a married person or a registered domestic partner is presumed to be community property, unless stated otherwise. Community property is equally owned by the couple and both parties must sign all agreements and documents regarding disposition of the property or the use of the property as security for a loan. However, at death, the decedent may dispose of his or her half interest in the community property by Will to anyone, not just to the other spouse or partner. Transfers occurring at death will usually require a probate or the filing of other non-probate court documents.

Upon the death of the first spouse, the basis in the entire property is adjusted to fair market value. In times of rising prices, the property will likely receive a step-up in income tax basis. This can provide significant income tax benefits upon a subsequent sale of the property. However, in times of declining prices, the property could receive a step-down in basis (if the fair market value of the property at the time of death is less than the owners' basis).

As for registered domestic partners, an adjustment to the income tax basis for the entire property will also occur on the death of the first partner, but only for California income tax purposes. Under current Federal income tax laws, only the deceased partner's interest in the property receives the basis adjustment.

An example of vesting would be: *Sam and Betty Smith, husband and wife, as community property.*

Community Property with Right of Survivorship: This title is also available to married couples or registered domestic partners. Containing all the benefits of the "community property" title discussed above, this title also means that the property will automatically pass to the surviving spouse or partner at the first death, without the necessity of a probate or other court-supervised procedure. The decedent's interest in the property ceases at the time of his or her death. Therefore, the automatic transfer to the surviving spouse or partner takes precedence over any contrary bequests contained within the decedent's Will. However, probate will generally

be required in cases of simultaneous deaths, or at the subsequent death of the surviving spouse or partner.

An example of vesting would be: *Sam and Betty Smith, husband and wife, as community property with right of survivorship.*

Joint Tenancy: This title may be used when two or more persons own equal interests in the property. Such persons may or may not be married or registered domestic partners. The ownership of the property automatically passes to the surviving joint tenant(s) at death. The decedent's interest is not controlled by the decedent's Will, and probate is generally avoided as long as there is a surviving joint tenant. Only the decedent's interest in the property receives an adjustment to the basis at the decedent's death. The basis in the pre-death share of the surviving joint tenant(s) remains the same.

Examples of vesting would be: *Sam and Betty Smith, husband and wife, as joint tenants, or Sam Jones, Betty Smith and Susan Johnson, as joint tenants.*

Tenancy in Common: This title reflects property owned by two or more persons in undivided fractional interests. In other words, the property interests of the various owners do not have to be equal. Each property owner can dispose of his or her interest in the property by sale or by Will. Transfer of a decedent's interest by Will generally will require a probate.

An example of vesting would be: *Sam Jones, a single man, as to an undivided 20% interest, Betty Smith, an unmarried woman, as to an undivided 40% interest, and Susan Johnson, a single woman, as to an undivided interest 40%, all as tenants-in-common.*

Persons acquiring property should always consult with legal counsel if there are any questions regarding how title should be held.

If you would like to receive further information regarding the topics in this newsletter, or if you would like to let us know any issues or topics you would like to see addressed in future newsletters, please contact us at (619) 239-7777 or newsletter@mmpph.com.

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