REAL ESTATE LAW AND ESTATE PLANNING UPDATE
SPRING 2008

With the 2008 Presidential campaign in full swing, the fate of President Bush's 2001 Tax Relief Act remains in the balance. That Act, which included a large tax cut package, along with significant changes to the estate tax, is set to expire at the end of 2010. The future of that Act and of the estate tax law will likely be decided by the new President and the new Congress sometime next year. I discussed many issues relating to estate planning under the 2001 Act in my Summer 2001 Newsletter. Several of those issues remain relevant and vital today, including mandatory and discretionary funding of exemption trusts, lifetime gift-giving, life insurance, and the step-up in tax basis.

While we are not able to predict what the new President and Congress may ultimately decide, one constant in the estate planning arena remains charitable giving which is discussed by Susanna M. Poon, below.

There are many different ways to reduce the size of your taxable estate through both lifetime and at death gifts. The most simple way is to take advantage of the **annual exclusion** which permits a donor to give away $12,000 each year to each donee without incurring any gift tax, while at the same time reducing the size of his/her total estate. Married couples can give away $24,000 each year to each donee by taking advantage of **"split gifts."**

Another away to reduce the size of a total estate is through charitable giving. During a donor's lifetime, he/she can make a gift to a **public charity** which qualifies for tax exempt status under IRC 501(c)(3) or a **private foundation** (including one established by the donor himself/herself) which is defined under IRC 509(a) and deduct the value of the gift from his/her individual taxable income (IRC 170).

The deduction will both lower his/her adjusted gross income (AGI) for the tax year and reduce the amount of assets includible in his/her gross estate. There is a limit on amount of the deduction depending on the type of the gift (cash, appreciated securities or others), the recipient of the gift (public charity or private foundation), and the donor's AGI.

However, if a donor wants to have all of his/her assets for use during his/her lifetime, he/she can make a **bequest through his/her will or trust** to a charitable organization (a public charity or a private foundation). At his/her death, his/her gross estate will be entitled to a charitable deduction for the full fair market value of the bequest (IRC 2055), thus reducing the size of the taxable estate.

For example, if an individual has a gross estate of $3,000,000 at the time of his/her death and leaves a $2,000,000 gift through his/her trust to a charitable organization, his/her taxable estate will be reduced to $1,000,000 which is less than the current lifetime exemption amount meaning that there will be no estate taxes owed on his/her death.

In addition to charitable bequests, another popular form of charitable giving is a **Life Income Gift** whereby the donor transfers property to a charitable organization which in exchange agrees to pay an income to the donor and/or another designated beneficiary for life or for a term of not more than 20 years. On the death of the income beneficiary or the expiration of the term, the balance of the gift is released to the charitable organization to be used for the purpose designated by the donor.

There are two popular types of life income arrangements:

1. **Charitable Remainder Unitrust.** Donor transfers assets <u>irrevocably</u> to a charitable organization, a bank or a third party individual to hold as trustee. The income paid to the donor or designated income beneficiary will vary each year and depends on the type of unitrust created.

   a. A "percentage" unitrust pays a fixed percentage of the trust's annual value. The distribution amount is paid each year first from income and then from principal.

b. A "net income" unitrust pays to the beneficiary a fixed percentage of the trust's annual value or the actual net income earned by the trust during the year, whichever is less.

2. **Charitable Remainder Annuity Trust.** This is similar to a Unitrust except that the donor will received a fixed dollar amount that does not fluctuate with the trust's annual value. If the trust assets do not produce enough income to make the payment, the donor would receive a portion of the principal.

There are three tax benefits for a Life Income Gift:

1. **Avoidance of Capital Gains Tax.** Owners of appreciated property must pay federal and state capital gains tax on the appreciated portion of any property they sell. However, charitable organizations are tax-exempt. They can sell the donated property with no tax on the capital gain and use the full fair market value of the gifted property for investment to produce an income for the beneficiary.

2. **A Current Income Tax Deduction.** In the year of the gift, a donor will receive an income tax charitable deduction equal to the present value of the charitable organization's "remainder interest" in the gifted property.

3. **Estate Tax Savings.** Assets donated to a charity during lifetime will not be available for inclusion in a donor's total estate at death. Additionally, when a testamentary life income gift is established through a decedent's will or trust, the decedent's estate receives a charitable estate tax deduction equal to the present value of the charitable organization's remainder interest.

Incorporating philanthropy into your overall estate plan will help reduce the size of your total taxable estate and provide support to charitable organizations. You should ask yourself what are the things that you care about and how do you want your property to help support those worthwhile causes? You can specify the use of your gift for a particular purpose within a charitable organization.

If you are considering making a charitable gift or bequest, please feel free to contact our office. We can assist you in the drafting of charitable trusts and/or testamentary documents as well as speaking anonymously with charitable organizations about how your gift may be used.

--Michael J. Festa is a graduate of the UCLA School of Law, and has been practicing in Santa Monica since 1979. His practice focuses primarily on real estate, business, estate planning and probate matters, and all related litigation.

--Susanna M. Poon has been practicing with Michael J. Festa since 2006. She works in all of the firm's practice areas.

--Visit our website, www.festalaw.com, for more information about the firm, as well as some of our newsletters from previous years. Or, contact Mr. Festa or Ms. Poon directly by phone or at mike@festalaw.com or susanna@festalaw.com, respectively.