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REAL ESTATE LAW AND ESTATE PLANNING UPDATE
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If you own all or a part of a business, any business, including a professional practice, corporation, partnership, or LLC, you should know something about and should have a **Buy-Sell Agreement**. Without having one, a closely held or family business faces a world of financial and tax problems on an owner's death, incapacitation, divorce, bankruptcy, sale, or retirement. A properly drafted Buy-Sell Agreement can prevent infighting and disputes between or among family members, co-owners, and spouses.

I will discuss this further, below, but first let's take a look at the new **Estate Tax Law**, resulting from the compromise legislation passed by Congress and signed by the President as part of the "fiscal cliff" resolution reached during the last days of 2012, and going into effect just over one year ago, including the new estate tax planning concept of **"portability"**.

I will also finish by taking a quick look at the current status of **non-recourse loans** in the commercial market.

Estate Planning: The 2012 Taxpayer Relief Act and "Portability".

Background. For many years, the estate and gift tax rules had been in a state of flux. In 2001, there was no gift tax and no estate tax on the first $675,000 of combined transfers during life or at death for gifts made by individuals. The so-called Bush Tax Cuts substantially increased the $675,000 exemption in stages after 2001. The exemption rose in steps to $3.5 million for individuals dying in 2009, with no estate tax for 2010; however, the gift tax exemption amount remained at $1 million for all years after 2001. During those years, the top estate and gift tax rate was reduced in stages from 55% to 45%.

The Bush Tax Cuts were scheduled to sunset at the end of 2010. However, the 2010 Tax Relief Act provided temporary relief, reducing estate, gift, and Generation Skipping Transfer ("GST") taxes for 2011 and 2012, with a $5 million exemption, a top tax rate of 35%, a step-up in basis (which was eliminated in 2010 when there was to be no estate tax), and introducing the concept of "portability", allowing a Deceased Souse's exemption to be shifted to the Surviving Spouse (without the need for a by-pass or credit shelter trust).

The 2012 Taxpayer Relief Act prevented the return of the harsher rules by enacting the following permanent changes to the estate and gift tax rules:

> **Exemption.** It set the lifetime exemption amount at $5 million per person, indexed for inflation after 2011. For 2014 gift and estate transfers, the exemption is $5.34 million.

Maximum rate. It set the top estate and gift tax rate at 40%.

Gift Tax: For 2014, the annual Gift Tax Exclusion amount remains at $14,000.00 per year per donor per donee.

Portability. This makes the Deceased Spouse's Unused Exemption Amount generally available for use by the Surviving Spouse (in addition to his or her own $5.34 million exemption) for taxable transfers made during life or at death, if elected by the Surviving Spouse upon the filing of an estate tax return following the Deceased Spouse's death.

This **portability election** may seem quite appealing in most instances. **Some of its advantages include**:

1) Simplified management and greater control of assets by the surviving spouse;
2) Flexibility for the surviving spouse to adjust the family estate plan to account for changing situations; and
3) Eligibility for all assets to receive a basis adjustment ("step-up") upon the surviving spouse's death.

However, such a plan also presents significant disadvantages, including:

1) Future appreciation on assets that could have funded a by-pass or credit shelter trust will not be sheltered from estate tax upon the death of the surviving spouse;
2) Creditor protection afforded by a by-pass trust will be unavailable;
3) The deceased spouse's $1 million exemption from real property tax reassessments will be lost;
4) The Generation Skipping Transfer Tax is not portable, so failure to create irrevocable trusts at the first spouse's death will result in loss of some GST planning, including gifts and bequests to grandchildren when their parents are still alive; and
5) Assets are not protected against or from the survivor's new spouse or other individual or organization interested in the money.

As with all estate plan designs, the particular circumstances of each family is paramount, and generally creating options through the use of a flexible plan will often be the best choice.

Business: Buy-Sell Agreements.

What if you and your best friend are "partners' in some business (real estate brokers or retail clothing boutique)? Your friend dies. Do you still have a business? Is your friend's spouse or child your new "partner"? Do you have the right or the obligation to buy out your deceased partner's interest in the business?

Suppose you have 10 "partners" instead of just one. What if one of your partners wants to retire? Or, go work for a competitor? Or worse, sell his or her interest to a competitor?

The beauty of a Buy-Sell Agreement is that it can provide for all of these, and many more uncertainties. And, there can be considerable flexibility to meet the needs and concerns of your business and its owners. And, there can be different terms for different events: e.g. retirement, bankruptcy, or death.

Life Insurance is another common component of a Buy-Sell Agreement. Although it is not necessary to have life insurance, it can often provide the liquidity if or when the time comes.

While these are difficult and uncomfortable issues for people to deal with, most Buy-Sell Agreements are fully reciprocal, so at least they become a bit easier to negotiate and agree upon, since the terms apply the same to all owners of the business.

Real Estate: Non-Recourse Loans.

A non-recourse loan structure has become the standard for real estate financing of stabilized commercial properties over the past 10 years or so. Under a non-recourse loan, the lender agrees that the borrower and its principals will not have any personal liability for failure to repay the loan, usually provided that a guarantor accepts liability for certain "non-recourse carve-outs" (typically referred to as "bad-boy" carve-outs or acts, such as misappropriation of rents or insurance proceeds, hazardous substances, filing of bankruptcy, etc.) This situation is distinct from the recourse loan structure often seen in a development or construction loan, where the failure to repay the loan does in fact result in personal liability to repay the loan, in the event that the foreclosed upon property is valued at less than the loan amount.

(In home ownership, most bank loans secured by first trust deeds, ["purchase money loans"] are, by law, considered non-recourse; however, certain home and apartment loans from third party, hard money lenders, and many 2nd trust deed loans and home equity loans, are fully recourse to the borrower, and could result in personal liability if the value of the home falls below the balance due on the loan.)

Lenders have been aggressively pursuing actions under the bad-boy carve outs, and attempting to restrict the application of California anti-deficiency laws in connection with commercial loans (that is, those laws restricting the ability of the lender to hold the borrower personally liable for the difference between the amount owed on the loan and the amount received through foreclosure.)

Owners of commercial real estate will need to carefully review and negotiate the terms of all non-recourse carve-outs to ensure that to the extent possible, events that are beyond their control or do not constitute their personal bad acts, will not provide a future basis for recourse liability, and to the extent that there is recourse liability, it is only for the lender's actual losses and not necessarily for the entire loan amount.

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