

Lakin Spears LLP

Trusts and  
Estates Group

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PLANNING UPDATE



L A K I N  S P E A R S LLP  
ATTORNEYS AT LAW

## Estate Tax Tumult

December 31, 2009, has come and gone and, contrary to all expectations, Congress failed to act to extend the federal estate tax. The scenario that no one thought possible is here: for a one-year period beginning January 1, 2010, the federal estate tax is repealed. The federal generation-skipping transfer (“GST”) tax is also gone. The gift tax, however, remains in place, with a 35% maximum rate (reduced from 45% in 2009) and \$1 million per person lifetime exemption. The genesis of this messy situation was in the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, which began a ten-year progression of increasing the estate tax exemption and decreasing the maximum tax rate.

Estate planners are now wondering if Congress will pass a bill to reinstate the estate tax during 2010, and whether that bill will be retroactive to January 1, 2010. The House passed a bill in December to extend the 2009 estate tax exemption and rate: A \$3.5 million estate tax exemption and a 45% estate tax rate. However, the bill on the Senate side never made it out of committee.

Congress’s inaction has created total uncertainty for estate planners, not just for 2010, but beyond. If Congress does not act during 2010, then the estate and generation-skipping transfer taxes will be restored on January 1, 2011 (when EGTRRA will sunset and the 2001 levels will return), with a \$1 million estate exemption and a 55% rate.

Along with the estate and GST tax repeal, another major change for 2010 is the elimination of the adjustment to the cost basis of a decedent’s property (exclusive of retirement accounts) to fair market value at death. The basis adjustment now is replaced by “carryover” basis, under which the decedent’s old basis is “inherited” by the heirs and beneficiaries. The only exception is that an estate’s executor may adjust the basis of the decedent’s assets by as much as \$4.3 million, with up to \$1.3 million of basis adjustment available to any beneficiary or heir, and an additional \$3 million of basis adjustment is available for assets transferred to a surviving spouse.

It is impossible to know what Congress will do. This makes estate planning for clients difficult, to say the least. Until the current quandary is resolved, we recommend the following to our estate planning clients:

1. If you have not already been doing so, we recommend that you keep and maintain good records regarding the cost basis of your assets, including your residence.
2. Although there is no generation-skipping transfer (GST) tax in effect for 2010, we are not recommending at this time that clients undertake substantial lifetime gifting to grandchildren (i.e., beyond annual exclusion gifts). We believe it is too risky because of the possibility that Congress will reinstate the estate and GST taxes for 2010, possibly retroactively. There could be a tremendous tax cost to misjudging the political landscape in 2010.
3. If you are married and your estate plan provides that the surviving spouse will not be the sole lifetime beneficiary of the Exemption/Bypass Trust, you may need to have your plan reviewed.

**This is an extremely complicated and murky situation, and the potential impacts of the situation depend on each individual plan. If you are concerned about how the 2010 rules and the possible changes slated for 2011 will affect your estate plan, please contact us.**

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## No Contest Clauses

No one wants a legal battle to develop over the distribution of his or her estate, yet litigation in this area is growing at a rapid pace. For example, a disgruntled beneficiary may bring a legal action to set aside a trust or will on grounds that the document was procured by undue influence or executed without sufficient capacity, or may assert a claim for money due from the decedent. Fearful of this, testators may be inclined to use “no contest” clauses, which threaten disinheritance to anyone who brings legal action challenging the estate plan.

While no contest provisions have been enforced in California, a complicated body of law has developed around them creating a virtual legal minefield of uncertainty. As a result, whenever legal action is contemplated that will involve a document containing a no contest clause, there is preliminary litigation to ascertain whether the underlying litigation will be a “contest” that will invoke the threatened disinheritance. This precautionary litigation creates delay and increased expense.

The Legislature has enacted significant changes governing no contest clauses which severely restrict their enforcement. The new law became effective on January 1, 2010. Most practitioners consider the new law an improvement, but it fails to resolve certain problems and presents some new ones. If your estate planning documents contain no contest provisions, you should discuss the effect of the new legislation with your estate planning attorney to make sure that your effort to avoid post-death litigation will be effective under the new law.

## Do You Know Who Your Beneficiary Is?

Did you know that the determination of who will receive the proceeds of your life insurance policies and your retirement accounts is not controlled by your will or trust? These determinations are made by the beneficiaries you have on file with the companies where you hold such assets. Therefore, it is very important to make sure that you have designated primary and contingent beneficiaries for such assets.

The beneficiary designations should be coordinated with your estate planning goals and documents, in the format recommended by your attorney. It is recommended that you obtain written confirmation from the appropriate companies that the designations have been accepted and processed as submitted.

If no beneficiary designations are on file for such assets at your death, the default beneficiary is often your estate, which means that the assets may have to go through an expensive probate court proceeding before distribution.

Lastly, keep in mind that these beneficiary designations may need to be updated periodically due to changes in the law or your personal situation.





## “And the Password Is...” Planning for Disability and Death in an Electronic Age

You, like many people, have an email account. You receive your bills and account statements electronically and handle your banking and purchases online. You may even have an account with eBay or a social networking site such as Facebook or LinkedIn. Have you ever wondered what happens to your electronic life if you become incapacitated or pass away?

In this event, it can be very difficult for your agent, successor trustee and other fiduciaries to access your digital property and other information to administer or settle your estate. For example, they may not know your passwords, login/user name(s) and automatic bill payment system. They may even need to file documents with a court in order to access such information. This process can be very time consuming, cumbersome and costly.

You can take steps now to provide these individuals with the vital information they need to electronically access your assets and related online financial information, and even your photographs and similar accounts. Individuals should create a list of their accounts, passwords and related key access information. Said list should be updated regularly and stored in a safe place accessible by your fiduciaries when needed. An electronic list may be more secure and more likely to be updated than a written list. It would also be helpful to provide your estate planning attorney with this information or a way to access it for your file.

## Convert to a Roth IRA?

The income limit on conversions to Roth IRAs is eliminated for 2010. Though you will pay income taxes on converted funds (you have two years to do so), your retirement benefits will continue to grow tax free inside the Roth IRA and no minimum distributions are required. Generally, it may make sense to convert if (a) you do not need to take distributions, (b) you can pay the associated income taxes from your non-IRA assets, (c) you do not expect a decline in your income tax rates in the near future, and (d) you wish to leave as much as possible of the account to the next generation.

## Estate Planning Opportunity for 2010

This is still a good time to consider gifting to a Grantor Retained Annuity Trust (“GRAT”). A GRAT is an irrevocable trust to which you will transfer assets that would otherwise be subject to estate tax in your hands at death. You must survive the term of years outlined in the GRAT to keep these assets out of your estate. A GRAT is a “discounting” device that allows you to make a gift at a value smaller than the current fair market value of the transferred assets. The less gift tax exemption you use, the more estate tax exemption you will keep to shelter the remaining assets in your estate. At the end of the term of the GRAT, if you survive, the assets that are not paid back to you in the form of an annual annuity pass to your intended beneficiaries, e.g. your descendants.

Founded in 1914 in Palo Alto, LAKIN•SPEARS, LLP is a law firm built on a long tradition of prompt, efficient and value-added legal service to our clients throughout the Bay Area. The firm specializes in estates and trusts, family law, real estate and business.

The Trusts & Estates Group provides the full range of legal services in the areas of estate planning, estate and trust administration, incapacity planning, guardianships, conservatorships, estate, trust and conservatorship litigation, and estate and gift tax return preparation.

Please contact us if you have any questions or concerns about the information in this Planning Update. This publication is for general informational purposes only, and is not specific legal advice or a substitute for advice from qualified counsel.

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