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Estate Planning and Tax Update 2001

Dear Clients and Friends:

New Tax Law

Undoubtedly, you now know that President Bush has signed into law the new Tax Act, HR 1836, also known as the "Economic Growth and Tax Relief Reconciliation Act of 2001." As reported by the media, the Act does eliminate the estate tax, but it does not eliminate the gift tax. In addition, the estate tax is repealed only for one year, which is the year 2010. All the provisions of the Act cease as of December 31, 2010, and the tax laws will return to the present law unless Congress enacts new tax laws in the future. **We are enclosing a summary of the new Act with this letter.** With the passage of the new Act, our advice at this time is:

- Do not make hurried or drastic changes if your estate plan has already been brought up-to-date since the last Tax Act in August of 1997. If your estate plan has not been reviewed since August of 1997, your estate plan should be reexamined to determine whether changes should be made based upon either the 1997 or 2001 Tax Act or based upon any changes in your family circumstances.
- Married persons with revocable living trusts containing marital deduction provisions resulting in the creation of a Marital Trust or a QTIP Trust at the death of the first spouse to die will likely need to have revisions made to the marital deduction language in their trusts that was in place prior to January 1, 2009, due to changes in the Act. The revisions will be necessary so that the marital deduction language in the revocable living trust will achieve the desired result of reducing federal estate tax at the death of the first spouse.
- Continue to make non-taxable gifts, such as annual exclusion gifts and direct payments of tuition and medical expenses, but consult us if you plan to make annual exclusion gifts to existing irrevocable trusts on or after January 1, 2003, as certain gifts to irrevocable trusts may no longer qualify for the annual gift tax exclusion after January 1, 2003.
- Because of the change in the estate tax exemption amount (see enclosed summary), clients whose will or trust makes mandatory use of this exemption (which likely includes most married couples with living trusts) should have their estate plan reviewed before January 1, 2002, when the new estate tax exemption amounts come into effect.

Privacy Notice

You have probably received multiple notices from financial institutions regarding notification of your privacy rights. The rule published by the Federal Trade Commission, "Privacy of Consumer Financial Information," 16 CFR Part 313, as required by § 504(a) of the Federal *Gramm-Leach-Bliley Act*, applies the Act to law firms which provide their clients with tax planning or tax preparation services. Because we are a law firm that provides our clients with such services, we are required to provide certain clients with this notice. Therefore, a Disclosure Notice is enclosed with this letter in compliance with the Act. Please understand, however, that we never give a client's name, address, or any information about the client to anyone other than the persons the client authorizes us to contact (such as a CPA).

New IRA Distribution Rules

The IRS has issued new distribution rules for retirement plans. A separate memorandum describing these new rules is enclosed.

Updates in Estate Planning Law

New Form of Taking Title – Community Property With Right of Survivorship. As of July 1, 2001, California Civil Code Section 682.1 provided a new form of taking title to property, other than joint accounts in banks or other financial institutions. The new form is taking title to property as "community property with right of survivorship." The intent of Section 682.1, by creating the community property with right of survivorship title, is to provide a form of title which can be terminated by affidavit after the death of either spouse, without requiring either a probate or a spousal property proceeding. Also, the intent in creating this new form of title was to entitle the entire adjusted basis of such property held as community property with right of survivorship to be stepped-up for income tax purposes under current income tax law. This step-up of the entire basis, however, changes with the 2001 Tax Act, but the changes do not become effective until January 1, 2010 (see enclosed Summary of the new Act, p. 3).

If you have a revocable living trust and all your property is properly vested in the trust name (i.e., vested in your names as trustees of the trust), or if you are not married, or if you want the property to pass to someone other than your spouse upon your death, this new form of title does not affect you, and you will not want to use this form of title in order to vest property. However, for a married couple who now has any property vested in their names alone as "joint tenants," we recommend that such property have the title transferred to this new form of title, which is "community property with right of survivorship" in order to preserve the step-up for the entire adjusted basis of the property, which consists of both halves of the community property. This step-up in basis may not occur if the property is titled solely as "joint tenants."

State Tax Credit Land Conservation. The California Natural Heritage Preservation Tax Credit Act of 2000 became effective July 7, 2000. The Tax Credit Act provides that if property is contributed to local or state governments, or to certain non-profit organizations (e.g., land trusts) between January 1, 2000, and December 31, 2005, in order to provide for the protection of wildlife habitats, open space, and agricultural lands, a tax credit equal to 55% of the fair market value of any such property for the taxable year of the contribution shall be allowed. If the entire credit is not used in the year of contribution, it may be carried over to the following year, and further carried over for up to seven succeeding years. This tax credit is a result of Senator O'Connell's reasoning that as a result of such contributions, the state gains by not paying the full value for conservation easements, and the taxpayer gains by obtaining the significant tax credit, which is much more valuable to the taxpayer because the taxpayer will receive a credit against net tax due rather than, under current law, just a deduction for an easement.

If Recently Moved to California, or if Moving out of California. There is no guarantee that a Will or Trust executed in another state will be valid in California for all purposes, or that a Will or Trust executed in

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California will be valid in another state for all purposes. In addition, there is also no guarantee that a Will or Trust drafted in one state will be interpreted in another state as you originally intended. If you own property that is not physically located in California, or there is a possibility that you may move out of California, you should ask us to review your estate planning documents to make sure the terms of such documents will transfer to another state, or you should have such documents reviewed by a lawyer in the other state.

Adoption Legislation. On October 6, 2000, the *Intercountry Adoption Act of 2000* (HR 2909) was signed into law, implementing the 1993 *Hague Convention on Protection of Children and Co-Operation in Respect of Intercountry Adoptions* (29 May 93), which legislation immediately (as of October 6, 2000) terminated some provisions of California adoption law pertaining to foreign adoptions. Additionally, since the 1980's, California has gradually moved to a more "open" adoption system. In 1997, the California Legislature authorized the use of "kinship adoption agreements" providing for continuing contact among adopting parents and birth relatives, and legislation last year expanded the use of these agreements (as of January 1, 2001), now called "Postadoption Contact Agreements," to non-related adopting parents. These changes in the law, and our changing social climate, mean that if any of your natural children were adopted by others, or if you have adopted children, your expectation of their inheritance rights (or lack of rights) might no longer be correct; and the use of the term "child," "children," "issue," or "descendants" in your Will or Trust may have to be modified. *We need to always be informed if any child of yours is a child adopted by you, or if any child of yours had ever been adopted by others, as either of these will affect how your estate plan is written.*

Annual "To Do" List

This is our annual reminder list of items for each estate planning client to check:

- Revocable Trust and Title of Assets.** If you have a revocable living trust which holds your family assets, remember that all of the family assets should be held in the trust name (i.e., your name(s) as trustee(s) of the trust) and should not be held in your individual name(s). Exceptions to this rule may include inexpensive automobiles and small checking accounts kept in your individual name(s) for convenience, if you so desire. Please take this opportunity to look at deeds to real property you own, your brokerage statements, your bank statements, any loans or notes being paid to you, any stock certificates, partnership or LLC papers, and any lease agreements in order to make sure that all pertinent documents display that such assets are held in name of your revocable living trust with you as trustee.
- Insurance.** If you have a revocable living trust, or have transferred property to a partnership, LLC, or corporation, you will want to make sure that all documents regarding your insurance (title insurance, homeowner's insurance, commercial liability insurance, fire insurance, earthquake insurance, etc.) have the name of your revocable living trust or the entity as an additional insured. Contact your insurance agent to arrange for this review.
- Beneficiary Designation Forms.** Certain types of assets (such as annuities, insurance contracts, IRAs, and pension plans) are not usually transferred to your revocable living trust, but rather their disposition on your death is controlled by beneficiary designation forms that you prepare and file with your insurance company or IRA or pension plan administrator. For almost all of our clients, we continue to recommend that the named beneficiaries of such assets be individuals (a spouse or children) and not the revocable living trust or your estate. Please double-check your beneficiary designation forms to make sure they properly reflect your wishes.
- Community Property Aggregation Agreement.** Our estate planning letter which was sent to you last year discussed the advantage of these agreements in order to allow a non-pro rata division of community property upon the death of a spouse, which is particularly helpful in sub-trust funding during the estate administration process. We recommend that all married persons with revocable living trusts sign such an agreement. If you have not yet signed this agreement, you can obtain a copy of the agreement and read the

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discussion in last year's letter by following the links on our Web Site at www.taxlawsb.com/resources/estates.htm, or call our office for information.

- Crummey Notices.** If you have a gift trust with "Crummey" powers, be sure the trustee sends the notices of withdrawal to the beneficiaries of such gift trust each year when contributions to the gift trust are made. In addition, make sure that the trustee keeps a file of the signed notices of withdrawal from each trust beneficiary as evidence that each beneficiary received such notice.
- Filing Gift Tax Returns.** It continues to be important that gift tax returns be filed for all gifts made, including gifts which fall under the annual exclusion for gifts, which is \$10,000 per donee per year, in order for the statute of limitation for an IRS audit to begin running and in order to comply with the rules for "adequate disclosure" which will start the statute running. ***Please note that our office no longer prepares gift tax returns.*** Therefore, you will want to work with your CPA to make sure any gift tax returns are timely filed.
- Information Availability.** As a practical reminder, keep all important documents and papers together in one safe place, such as a safe deposit box, and make sure every member of your family knows where these papers and documents are. Include with these papers and documents a list of the names, addresses, and telephone numbers of all your advisors and of all your family members or others named in your trusts and wills, as well as a list of the locations of original documents that may not be in your possession (e.g., if our office or a financial advisor is holding the originals for safekeeping).
- Family Changes.** If there have been new births, marriages, divorces, adoptions, or deaths within the family, review your trust and will(s) to make sure they still reflect your wishes. There are certain steps which must be taken following a death in the family. For example, several different time deadlines are imposed, with some deadlines occurring as early as 30 days after the date of death, and stiff penalties are imposed for missing some of these deadlines, such as the imposition of interest and penalties for failure to pay estate taxes nine months following the date of death. Please do not delay in letting our office, or another attorney who will handle the decedent's estate, know of a death in the family.

We hope this letter provides you with some insight with regard to the new Tax Act and the various changes in the tax law and in estate planning since our last letter to you. Please contact our office if you have any questions, or if you would like to set up an appointment to have your estate plan reviewed in light of these new laws

Sincerely yours,

AMBRECHT & ASSOCIATES