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OVERVIEW OF GIFT AND ESTATE TAXES, INCOME TAX BASIS RULES, AND CALIFORNIA REAL PROPERTY TAXES
(For transfers in 2015 and thereafter)

Cautionary Note: This is general information for discussion purposes only, and does not constitute tax, legal, or other professional advice.

1. Gift tax rules. A federal gift tax is a tax assessed on the right of a person to give away assets during lifetime.

a. Annual exclusion. Our 2015 gift tax rules allow a person (called a "donor") to make annual gifts to each of any number of recipients (called "donees") of $14,000 or less without any reporting requirement or any gift tax being assessed.

b. Additional lifetime exclusion. A donor may also make additional lifetime gifts (in the aggregate to all donees), without any gift tax being imposed, totaling $5,430,000 or less (for 2015 and prior years combined). Using any part of this lifetime exclusion requires reporting on U.S. Treasury Form 709 (due on April 15th of the year following the gift being made). The amount of the lifetime exclusion used reduces (on a dollar for dollar basis) the exclusion available to the donor for estate tax purposes at the donor's death.

c. 40% gift tax rate. Any lifetime gifts made in excess of the lifetime exclusion will be taxed at 40%.

d. Strategies. For very high net worth individuals, a program of lifetime gifts can prove beneficial for both tax and practical reasons. A program might involve annual exclusion gifts, 529 Plan (educational) gifts, direct payments to providers for tuition and medical expenses, qualified personal residence trusts (QPRTs), charitable remainder trusts (CRTs), private annuities, the creation of limited partnerships and limited liability companies (LLCs), and other vehicles.

2. Estate tax rules. A federal estate tax ("Estate Tax") is a tax imposed on the right of a person ("decedent") to give away assets at death.

a. Due date. The Estate Tax is due and payable in full nine months following the decedent's death, unless an extension or long term payment plan is available.

b. Computation. The Estate Tax is assessed against a decedent's "net estate". To determine the "net estate", you first value the decedent's gross assets at fair market value (not cost). This includes proceeds payable at death from life insurance policies and pension and profit-sharing plan benefits, if the decedent had the right to designate who would receive them at death. Next, you deduct any mortgages, debts, funeral expenses, and administration expenses.

c. 100% spousal exclusion. Any part of a decedent's net estate which passes to a spouse **who is a United States citizen** (either outright or in a qualifying manner, such as a Qualified

Terminable Interest Property - or "QTIP"- Trust) passes free of Estate Tax. Effective January 1, 1989, any property passing to a **non-citizen spouse** may qualify for this exclusion but only if the disposition satisfies many technical "Qualified Domestic Trust" ("QDOT") requirements.

d. 100% charitable exclusion. Any part of a decedent's net estate which passes to a qualifying charity (either outright or in a qualifying manner, such as a charitable remainder trust) passes free of Estate Tax.

e. Exclusion amount; tax rates.

(1) For deaths in 2015. For deaths in 2015, the first **$5,430,000** of assets passing to persons other than a spouse, or charities, is free of any Estate Tax. Any assets in excess of the exclusion amount are taxed at a **40%** flat rate.

(2) Portability of a Decedent's Unused Exclusion. If the first spouse dies without using his or her full exclusion amount, then the unused portion may pass to ("be ported to") the surviving spouse. Illustration: husband dies in 2015, leaves $2,000,000 to his children, and leaves everything else to his wife; at wife's subsequent death, she may be able to add husband's unused $3,430,000 exclusion to her own then available exclusion ($5,430,000 for deaths if she dies in 2015), for a total available Estate Tax exclusion at wife's death of $8,860,000 (husband's unused $3,430,000 exclusion, plus wife's own $5,430,000 or other then applicable exclusion). There are specific rules which must be followed to qualify for portability.

(3) Unification of Gift and Estate Taxes. Recall that if husband gives away $1,000,000 during his lifetime, then he only has a $4,430,000 exclusion left at his death. In other words, husband has only a $5,430,000 combined [unified] gift and estate tax exclusion. He can use the exclusion entirely during lifetime (so he would have no exclusion available at his death); or he can use the exclusion entirely at his death; or he can use part of his exclusion during his lifetime and the balance at his death.

3. No Separate California Estate Tax. On June 9, 1982, California abolished its separate "inheritance tax" system. For deaths prior to 2005, any federal Estate Tax computed under paragraph 2 above was divided between the federal and California governments. For deaths in 2005 and later, the federal government eliminated California's right to receive any portion of the federal Estate Tax. We no longer file any Estate Tax return with California. If a California decedent owns real properties outside California, however, those other states may (or may not) impose an estate or inheritance tax.

4. Income Tax Basis Rules. If you sell an asset during your lifetime, you may have to pay a capital gains tax on the capital gain (sales price less cost basis = capital gain). At death, however, a decedent's cost basis for most assets (excluding, however, individual retirement accounts and qualified retirement plan benefits) is increased to fair market value at the date of death [IRC Section 1014]. Therefore, if a decedent's beneficiary sells the asset following the decedent's death at the date of death value, the beneficiary will have no capital gain to report, and will pay no capital gains tax. Special basis rules also apply with respect to spouses.

5. Real Property Tax Rules. When California real properties pass from a decedent to beneficiaries (outright or in trust), the real property taxes may be reassessed (increased) under Proposition 13. The rules are complex, but the following outline may be helpful:

a. Spousal Exclusion. There is no reassessment (increase in real property taxes) when real property passes outright to, or in special trust ways for the benefit of, a decedent's spouse or registered domestic partner.

b. Limited Parent-Child Exclusion. There is no reassessment (increase in real property taxes) on the following transfers of real property to children (so long as the transfers are made outright or in special qualifying trusts):

(1) A principal residence of any value.

(2) Other real properties with an aggregate assessed value of $1,000,000 or less.

c. Special Entity Rules. If the real property is held in the name of an entity (such as a corporation, or a limited partnership, or a limited liability company), then the parent-child exclusion is not available; a special form (Board of Equalization Form 100-B) must be filed within ninety days following a decedent's death; and when more than 50% of the total ownership of the entity changes hands, there may be a reassessment of 100% of the real property owned by the entity.