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Hoffman, Sabban & Watenmaker strives to keep its clients and friends informed of important developments affecting their estate, gift and tax planning. This letter summarizes some of those developments.

Tax Exclusion Amounts

The lifetime estate and gift tax applicable exclusion amount (or exemption) for 2015 will be $5,430,000 (up from $5,340,000 in 2014). This amount is adjusted for inflation every year. The lifetime Generation-Skipping Transfer (GST) tax exemption will also be $5,430,000 for 2015 (also up from $5,340,000 in 2014); this amount is also adjusted for inflation every year. The amount of an estate over these exemptions will still be taxed at 40%.

"Portability" of a deceased spouse's unused applicable exclusion amount (for estate and gift tax purposes, but not for GST tax purposes) continues to be available. This means that, if a spouse dies without using all of his or her exemption, the surviving spouse can use the "unused" portion during his or her lifetime or at his or her death. (This benefit disappears if the surviving spouse remarries and the new spouse dies before the surviving spouse.) In order to preserve the ability to use the unused exemption, an estate tax return must be filed for the first spouse's estate, even though there is no tax due and a return may not otherwise be required to be filed.

The gift tax annual exclusion in 2015 will remain at $14,000 per recipient, for each donor. This amount can be doubled to $28,000 if the donor's spouse joins in the gift.

Same-Sex Marriage

In June 2013, the United States Supreme Court ruled that Section 3 of the Defense of Marriage Act (DOMA) is unconstitutional. The federal government now recognizes same-sex marriages. On August 29, 2013, the IRS further clarified the treatment of same-sex married taxpayers in Revenue Ruling 2013-17, which was effective September 16, 2013. A same-sex marriage will be recognized for all federal tax purposes if the marriage was valid in the state where the marriage took place, regardless of the laws of the state where the couple is domiciled. However, registered domestic partners will not be treated as married for federal

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purposes. Therefore, if registered domestic partners want to be treated as married under the federal tax code, they will need to legally marry.

For estate and gift tax purposes, same-sex married individuals can now make gifts to each other during their lifetimes without gift tax, due to the unlimited marital deduction. Also, property left to a surviving spouse at death qualifies for the marital deduction against the estate tax, thus allowing same-sex married couples to defer the payment of estate tax until the second death. Same-sex married couples can also take advantage of "portability" of the deceased spouse's unused estate tax exemption. This discussion assumes that both spouses are U.S. citizens; if your spouse is not a U.S. citizen, please contact us so that we can describe the special rules that apply when a spouse is not a U.S. citizen. Any gift tax returns or estate tax returns recently filed should be reviewed to see if they should be amended to claim the marital deduction, if the period for amending the return is still open.

Same-sex married couples may, but are not required to, amend previously filed income tax returns as married individuals for tax years that are still open under applicable limitations periods. For tax year 2013 and later, every same-sex married individual must file income tax returns as a married person - either married filing separately or married filing jointly.

The Retirement Equity Act now applies to same-sex married couples. As a result, if one spouse participates in a qualified retirement plan and designates a beneficiary who is not the other spouse, the other spouse must consent to the designation. Consents are also required for certain actions, such as electing to take a lump sum distribution from a qualified retirement plan.

Existing estate plans of same-sex married couples should be reviewed to see how these changes impact the estate plan. Beneficiary designations for retirement assets and life insurance policies should be reviewed to determine if they are still appropriate.

Digital Assets

There is an often overlooked category of assets that you should consider when creating an estate plan: digital assets. These include accounts such as online banking and securities accounts, PayPal, eBooks, Amazon, eBay, Facebook, Twitter, Pinterest, Dropbox, Instagram, Picasa and Snapfish (and other online photo albums). Online gaming has reached epic popularity, with some items costing players enormous amounts of real money to acquire, which they can resell. The average person has 20 to 25 digital accounts, and those accounts may be inaccessible when the person becomes incapacitated or dies. Automatic payments from bank accounts would continue until the bank is notified.

In some cases, digital assets and media assets that have been paid for can be passed on to a decedent's heirs. In other cases, a person only has a license to use assets, such as e-books, and upon death, the license ends so that no other person can use the assets. Bitcoins have become increasingly popular; this form of electronic currency can be left to heirs.

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Treasured family photos might be kept only in digital format, and access to them may be very important to family members and other loved ones. Often, a service provider will not disclose a deceased person's passwords to the Executor or Trustee, and there are very few laws to help an Executor or Trustee in this situation. Those "terms of service" agreements that we all "agree" to with a click often include provisions about what will happen in the event of death.

We urge our clients to consider whether to leave important information about digital accounts with a trusted person, or in a location where the information may be found (perhaps with the Will, Trust or other important documents). The estate plan can name a "digital fiduciary," who would be given the right to access digital information, such as login names and passwords, but it remains unclear if all websites will honor this designation. Login names and passwords can be kept in a digital password vault, which may be more secure than written form. The digital fiduciary would only need information for one website (the login and password to access the digital password vault), where all other pertinent digital information is stored. Whether in written or electronic form, this information should be updated regularly, as the makeup of digital assets changes.

Our clients should also consider whether they want to leave digital assets to particular individuals, so that these gifts can be included in the Will or Trust.

529 Education Plans

"529 Plans" are funds established to pay for higher education expenses for another person. These funds grow tax free, and if the funds are later used for qualified educational expenses of the named beneficiary, there is no income tax due as the funds are used. If you have established any 529 Plans, you should consider carefully how to leave these plans upon your death. The fact that you have named a beneficiary does not guarantee that the beneficiary will actually receive the benefits (unlike an IRA or life insurance beneficiary). This is because the "owner" of a 529 Plan can change the beneficiary.

If, for example, you have established a 529 Plan for a grandchild and you die before the grandchild uses the funds, and if your estate plan leaves your estate to your children, that 529 Plan may end up being owned by your child who is the parent of the grandchild/beneficiary, or by your other child. The new owner of the 529 Plan can name himself or herself as the new beneficiary, thus thwarting your original intention to benefit your grandchild. You should consider whether you want to leave the 529 Plan specifically to your child who is the beneficiary's parent (trusting that your child would want his or her own child to receive the benefits as intended), or directly to the grandchild/beneficiary (which might require naming a Custodian to hold the 529 Plan for the beneficiary if he or she is a minor), or to a trust for the grandchild. You could set up a 529 Plan account under the Uniform Transfers to Minors Act so that you hold the account as custodian for the beneficiary, but in that case, you could not change the beneficiary (say, if the grandchild decides not to go to college), and the beneficiary would obtain full control of the account when the beneficiary reaches the age of majority for the plan (ordinarily, age 18, unless the account specifies a later age, generally up to age 21).

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Make Gifts

The gift tax exemption in 2014 is $5,340,000, and is scheduled to increase to $5,430,000 in 2015. Thus, even if you have used all of your exemption through 2014, you will have an additional $90,000 of exemption to make gifts in 2015 and beyond. (This exemption is in addition to the annual exclusion of $14,000 per recipient.) Making lifetime gifts has the benefit of enabling your family to enjoy the assets now, and all future income and appreciation on the assets you give away will escape estate taxes on your death. One downside to making a lifetime gift is that the recipient receives your income tax basis in the gifted asset, rather than receiving a step-up in basis for income tax purposes if you were to hold the asset until death.

Even if you make gifts in excess of the gift tax exemption and have to pay some gift tax, it is still cheaper to make lifetime gifts than to leave those assets at death, assuming you live for more than three years after the date of the gift. This is because estate taxes are tax inclusive, meaning that your estate will have to pay estate taxes on the cash used to pay the estate tax. On the other hand, if you make large enough gifts to warrant paying a gift tax, it is tax exclusive, meaning that you only pay gift taxes on the portion actually passing to the recipient. Thus, even though the nominal gift tax rate on such "excess" gifts is 40%, the "effective" rate is only 28.6%.

Grantor Retained Annuity Trust Is Still a Good Technique

A Grantor Retained Annuity Trust ("GRAT") is a trust which provides you (the grantor) with an annual payment (annuity) for a specified term of years (selected by you). You are deemed to make a taxable gift to the "remainder beneficiary" equal to the present value of that remainder interest. A typical GRAT, however, is designed so that the value of the remainder interest is zero. The annuity amount includes an IRS approved rate of return which is the rate that the GRAT must outperform for it to provide any benefits to your named beneficiaries. (It has been 2.2% annually for most of 2014.) Typically, at the end of the GRAT term, any assets remaining after the annuity payments have been made to you will pass to your beneficiaries gift-tax free. However, if you were to die before the end of the GRAT term, then all or a portion of the GRAT assets would be includible in your estate for estate tax purposes.

Sales of Assets to Grantor Trusts Can Shift Appreciation to Heirs

Another effective estate planning technique is the use of intentionally "defective" grantor trusts ("IDGT's") to hold gifts for the benefit of children and grandchildren. These trusts not only allow you to take advantage of all of the tax benefits of lifetime gifting (as described above), but they also permit you, as the grantor, to continue to pay income taxes attributable to the gifted assets gift-tax free. Thus, the assets in the IDGT can grow for the trust's beneficiaries without being depleted by any income tax liability. In addition, any transaction (such as a sale or exchange) between the grantor and the IDGT will not be considered a taxable event, so a sale between you and the IDGT will not incur any capital gains tax. If at some point you tire of incurring the income tax liability, you can terminate the "grantor trust" status

of the trust by releasing certain powers; however, this release may be a taxable event that can trigger any deferred capital gains tax at that time.

In light of the current low interest rates, you should consider selling income-producing assets (that you do not need) or assets that are likely to appreciate in value to an IDGT. The sale would require a reasonable down payment (between 10% and 20%) and a promissory note for the balance. The minimum interest rate required by the IRS in November 2014 is 0.39% for loans of three years or less. After the sale, all income attributable to the assets purchased by the IDGT, as well as all their appreciation, passes to the IDGT beneficiaries gift-tax free.

Charitable Remainder Trusts

Charitable Remainder Trusts ("CRTs") may increase in popularity with estate planners due to higher capital gains rates and the imposition of the new Medicare surtax. Assets that you transfer to a CRT can be sold by the CRT with no current capital gains tax due to its charitable status. You receive an annual payment from the CRT for a specific number of years, or for your lifetime (either a stated annuity amount or a percentage of the value of the assets in the CRT), but this payment will likely be subject to income taxes or capital gains taxes. The assets remaining at the end of the CRT (i.e., at your death or the end of the selected term of years) pass to one or more charities you name. When you first set up the CRT, the present value of that charitable remainder interest is calculated, which you can claim as a charitable deduction on your current income tax return to offset your income and other capital gains.

With the top federal capital gains rate of 20%, highest California State tax rate of 13.3%, the Medicare surtax of 3.8%, and the reduction of certain deductions by a percentage of income over a certain level, you may be much better off selling assets with considerable built-in gains through a CRT, where none of these taxes would apply (at least currently). The annual payments you receive from the CRT would likely be subject to some taxes, but the overall tax savings may still be significant.

Overtime Compensation to Home Caregivers

Beginning in 2014, the California Domestic Workers Bill of Rights Act requires that caregivers who work more than nine hours in a day or more than 45 hours in a week be paid overtime. Also, a previous exemption from minimum wage and overtime laws for caregivers employed by third party entities such as homecare agencies has been removed. Now, all home caregivers must receive minimum wage, and overtime when appropriate.

Make Sure Title to Real Estate Is in Living Trust

When a loan is refinanced, the lender normally requires that title to the property be removed from a living trust until the loan papers are recorded. Afterward, the lender will not object to returning title to the living trust, but the lender generally does not remind the borrower to do so. If you have refinanced your home or any other real property, you should

check the title to the property to make sure it has been returned to your living trust. We can assist you in checking title, and in preparing a deed to return the property to your trust, if needed.

Firm Recognitions

We are pleased to have been recognized for the quality of our work by the following:

- *U.S. News - Best Lawyers* - Our Firm received a Tier One (highest) ranking in its 2014 Edition of "Best Law Firms".

- *U.S. News - Best Lawyers* named Paul Gordon Hoffman the Trusts & Estates Lawyer of the Year for 2014.

- Paul Gordon Hoffman, Alan S. Watenmaker, Geraldine A. Wyle, Erin L. Prouty, Chang Chae, and Kenneth S. Wolf* are Fellows of the American College of Trust and Estate Counsel (ACTEC).

- *Los Angeles Magazine* listed Paul Gordon Hoffman, Alan S. Watenmaker, Geraldine A. Wyle, Jeryll S. Cohen, Erin L. Prouty, Chang Chae, Mary Ramsden and Kenneth S. Wolf* as "Super Lawyers" for 2014.

- The following attorneys have been selected for inclusion in the 2014 edition of *Best Lawyers in America*:
  - Paul Gordon Hoffman, Alan S. Watenmaker, Kenneth S. Wolf*, Jeryll S. Cohen, Erin L. Prouty and Danielle E. Miller - *Trusts and Estates*,
  - Paul Gordon Hoffman - *Tax Law,* and
  - Geraldine A. Wyle, Kenneth S. Wolf* and Jeryll S. Cohen - *Litigation - Trusts and Estates*.

We would be happy to discuss with you the best options for taking advantage of any of the opportunities described above. Please contact us if you are interested in discussing these opportunities or in reviewing your estate plan to ensure that it meets your current objectives.

*Mr. Wolf is Of Counsel to Hoffman, Sabban & Watenmaker, APC