ZOLLA LAW FIRM

DECEMBER 2006 NEWSLETTER

ESTATE TAX UPDATE

Despite a noble attempt this summer, 2006 saw no changes in the estate tax law. Right now, the credit from estate taxes is $2 million, is scheduled to increase to $3.5 million in 2009, and will drop to $1 million in 2011. The magic year – 2010 – will have no estate taxes, but we will lose the step-up in basis at death in the larger estates. Hopefully, the new Congress and the President will settle on a reasonable, workable law once the new session begins in January.

BE CAREFUL IF A FRIEND BECOMES YOUR CAREGIVER

You'd be suspicious if your elderly rich uncle suddenly died and gave all of his money to his night nurse, right? So is the State of California.

In 1993, the legislature first enacted a law (Probate Code Sections 21350 through 21351) to invalidate bequests to (among others) people who had acted as the "care custodian" of a decedent. The term care custodian includes professional caregivers and nursing homes, but also includes nonprofessionals who undertake similar tasks, such as bathing, assisting with medications and ointments, and diapering, along with grocery shopping and meal preparation.

There are many exceptions to the rule, including gifts worth less than $3000 and gifts when the care custodian happens to be related to the decedent. Also, the gifts will be valid if the decedent asked an independent lawyer to sign a Certificate of Independent Review, confirming that the decedent was not under pressure from the beneficiary. Finally, following a death, a beneficiary can validate the gifts if she can prove, by clear and convincing evidence (a very hard standard) that the transfer was not the product of fraud, menace, duress, or undue influence.

But what if you have a good friend, who you've known for years, who cares about you so much she agrees to move in with you and take care of you once you get sick? Should gifts to that friend be invalidated?

Most lawyers thought those gifts were okay, because the good friend was acting the way a relative would act; and gifts to relatives are not disqualified.

But, after many years of debate in the lower courts, the California Supreme Court recently ruled in Bernard v. Foley that gifts to friends, who become your care custodian, even if they are not paid and do not have specialized training, are invalid, unless an exception applies. There is no personal friend exception to the rule against bequests to care custodians.

We aren't always luckily enough to live near our family during a protracted illness. It's possible the legislature will re-write the law. Until that time, we need to be aware of the issue, and please let me know if it's possible a dutiful friend (named in your estate planning documents) has become so essential in your daily care that she could be considered a care custodian.

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ROLL-OVER YOUR IRA TO CHARITY

One of the most exciting laws this year relates to withdrawals from IRAs for charitable benefit. Traditionally, if someone wanted to take money out of his IRA to donate to charity, he would have to make the withdrawal and pay income tax before gifting the net amount to charity. Sure, he would get an income tax deduction for the donation, but the charity would get substantially less from the IRA.

Now, you can distribute up to $100,000 from an IRA directly to charity, without having to pay any income tax on the withdrawal. You do not get a charitable deduction, but you also don't have to pay any income tax. Here's the fine print:

* You must be 70 ½ or older;

* You can only do this in 2006 and/or 2007;

* The donation must come from a traditional IRA (not a 401(k) or SEP); and

* The donation must go to public charities (and limited other charitable organizations).

Why would you do this? Well, the donation to charity can be used to reduce your Minimum Required Distribution (MRD) for the year. If you have a very large IRA, other assets you're using for cash flow, and a lot of charitable intent, you can get a bigger bang for your buck by making this direct donation to charity. Also, if you are in a tax situation where any MRD increases your phase-out of itemized deductions, increases your tax bracket, or otherwise impacts your income taxes, you may have a better tax result by giving the MRD directly to charity, even if you lose the tax deduction.

Obviously, you must consult with an accountant before deciding to make this gift.

529 PLANS MADE PERMANENT

Many of my clients with young children or grandchildren are taking advantage of college savings accounts known as "529 Plans". These accounts are created with post-tax dollars, but grow tax free and, when the child uses the money for college or other higher-education expenses, the funds are withdrawn free of any income taxes.

529 Plans are great vehicles for $12,000/year annual gifts because they have the potential to grow tremendously during childhood.

What many people didn't realize was that the law was set to expire in 2010 and, after that time, it was possible that withdrawals from accounts could have been subject to income tax!

Well, in the same law that allowed charitable IRA rollovers, mentioned above, Congress agreed to extend the 529 Plan law permanently! Now that there is no more uncertainty, there are no more excuses to delay funding your child's or grandchild's education.

A PERSONAL NOTE

My son, Aaron, is now 2 ½ and my daughter, Abby, is now 9 months old. Aren't they cute?

Thanks to all of you, my wonderful clients, colleagues, and friends, for respecting my three-day schedule and for your continued referrals. I can only accomplish this work-life balance with your help.
Happy Holidays!

Carol

Also: I will be raising my fees for new clients (the first time in 3 years) beginning March 1. If you know someone who has been thinking of creating an estate plan, have them contact me before that date.