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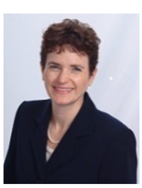
Tom Monson and the 2011 Farmers Insurance Open Winner, Bubba Watson.

FIRM NEWS

Our Senior Partner Tom Monson recently played in the Farmers Insurance Open Wednesday Pro Am on the south course of Torrey Pines Golf Course. Tom's team took third place. Tom was the President of the Century Club of San Diego and the Chairman of the Farmers Insurance Open Tournament in 2012. The Century Club of San Diego is a 501(c)(3) charitable organization that administers and promotes San Diego's annual PGA TOUR event, The Farmers Insurance Open. The annual net earnings of the corporation are used solely for charitable purposes, with a focus on San Diego at risk-youth and youth charities. The Century Club has generated over $26 million for San Diego charities since 1961. In 2013, almost $2.4 million were raised, and it is expected that the 2014 tournament will exceed that amount. Tom has been a member of the Century Club since 1996. For more information on the Century Club, go to http://www.farmersinsuranceopen.com.

IN THIS ISSUE:



HOW YOU HOLD TITLE TO CALIFORNIA REAL PROPERTY MATTERS

DeEtte L. Loeffler, J.D., LL.M. Taxation

The way in which you hold title to your real property matters. It controls what rights you have, what taxes you pay, and even what your income tax basis will be upon a death. Realtors and escrow companies are not permitted to give you legal advice and often do not completely understand these critical differences. Since few people hire an attorney to advise them when purchasing real property, the results can be, in a word, unfortunate. This article summarizes the major forms for holding title in California and makes some recommendations for how you might want to hold yours.

Ways to Take and Hold Title. California offers five different options for holding title to real property: sole and separate property, tenants in common, joint tenancy, community property, and community property with right of survivorship. California does not allow the holding of real property in a "tenancy by the entireties". Only married persons and registered domestic partners ("RDPs") are permitted to hold title as community property, but anyone can hold title alone, as a tenant in common, or as a joint tenant.

Property Interests That Come With Title. Ownership of real property is comprised of several different rights, commonly referred to as a "bundle of sticks". These rights include the rights to occupy or otherwise use the property, to mine or drill under it, to build on it, and to rent, lease or sell it. Owning property also comes with responsibilities, such as personal liability for injuries incurred by others on the property and the duty to pay property taxes. The manner in which you hold title affects which of these "sticks" you possess. Most property does not include the right to drill or mine, as these rights were usually retained by previous owners. In addition, most property is subject to easements by third parties, such as the telephone or cable company, the power company, etc. Easements allow these third parties to run lines over and under your property and to maintain them in order to provide services to other customers. There may also be easements for a neighbor's driveway or a public sidewalk.

Sole and Separate Property. Anyone, married or single, can own real property in his or her sole name. The owner holds all interests in the property (usually other than drilling) and can lease, sell, gift, or otherwise transfer the real property without anyone else's consent. The owner is solely responsible for all property taxes, and is solely liable for any injuries incurred on the property. At the owner's death, the property will receive a new basis for income tax purposes equal to the then fair market value of the property and will pass to his or her chosen heirs under an estate plan (or by intestate succession).

Tenants in Common. Anyone, married or single, can hold an interest in real property with one or more other people or entities as a tenant in common ("TIC"). There is no limit to the number of people who can own a property as tenants in common. Each TIC holds an undivided right to a specific percentage of the property but can use the *entire* property. He or she is permitted to sell, gift, or otherwise transfer his or her interest in the property (if he or she can find a buyer). Further, a TIC can force a partition of the entire property to permit a sale to a third party if he or she is unable to find a buyer for his or her fractional interest. Each owner is entitled to a share of any income (or loss) generated by the property consistent with his or her ownership percentage and is responsible for the property taxes attributable to that percentage interest. In a dispute with third parties, each owner can be held equally liable by a third party for all injuries incurred on the property. Each tenant holds his or her interest as separate property. At death, only that interest will receive a new fair market value income tax basis and it will pass to the TIC's chosen heirs under an estate plan (or by intestate succession).

Joint Tenancy. Anyone, single or married, can hold property in a joint tenancy with a spouse or other person. As with a tenant in common, there is no limit to the number of people who can jointly own a real property. Each owner will have an equal interest in the property during their lifetime (there are no unequal owners in a joint tenancy), but a married couple can together own one share. Each joint tenant can use the *entire* property. He or she is permitted to sell, gift, or otherwise transfer his or her interest in the property, but before a transfer can take place, the joint tenancy must be severed (which is easy to do). Each owner is entitled to an equal share of any income (or loss) generated by the property and is responsible for an equal percentage of the property taxes. In a dispute with third parties, each joint tenant can be held liable by a third party for all injuries incurred on the property. Upon the death of a joint tenant, the other owners automatically inherit the decedent's share without the need of a probate, and the decedent's share of the property is entitled to a new fair market value income tax basis.

Transferring property to a joint tenancy is a gift (unless you sell it) that instantly triggers (i) a possible reassessment of the property taxes and (ii) a federal gift tax (depending on the size of your estate). This gift cannot be undone, so be careful who you add to your property as a joint tenant. Also, because joint tenancy property passes automatically at your death, you cannot gift it to anyone in your Will or trust. For example, if you hold real property in a joint tenancy with your son and his spouse, and you want to leave your interest only to your child, you will first need to break the joint tenancy before you die - otherwise both the child and his spouse will inherit your share. If you find yourself in this situation, we recommend you seek legal advice about your options immediately.

Community Property. Only married persons and RDPs can hold title to California real property as community property. Community property can be held in two forms: as simply community property or as community property with right of survivorship. The key difference with the second form of title ("with right of survivorship") is that title automatically passes to the surviving spouse without the need of a probate proceeding which can be a significant cost saver. Most escrow companies, however, only prepare deeds for simple community property ownership.

Community property gets very favorable tax treatment in exchange for some limitations on ownership rights. Each spouse owns an undivided 50% interest in the property. Spouses cannot, however, sell, gift, or otherwise transfer an interest in community property without the consent of the other spouse, and they cannot unilaterally terminate the community property title or force a partition of the property for sale. Each owner is equally entitled to all of the income (or loss) generated by the property and is responsible for all of the property taxes. In a dispute with third parties, each spouse can be held liable by a third party for all injuries incurred on the property, but damages must be paid first from community property assets.

One significant benefit of community property ownership is the way it is treated for tax purposes. At either spouse's or (or RDPs) death, the *entire property* is entitled to a new fair market value income tax basis (not just the decedent's 50%). In addition, transfer to community property ownership does not trigger a reassessment of the property taxes, nor does it generally result in a taxable gift (although non-citizens who are also non-residents are limited in the value they can transfer each year).

What is The Best Title For You? It depends. It is always better to seek legal advice before you sign a deed to avoid unexpected tax and liability problems. In the absence of this, it is usually better for married persons to hold title to real property as community property with right to survivorship, although it is even better to then transfer that property to a trust. Tenancy in common can be a good option, although we strongly recommend you enter into a co-ownership agreement to control the rights to partition and use the property. Also, you should be advised that if spouses put a joint tenancy property into a trust, the property generally remains the separate property of each spouse, and therefore, will lose out on the full step-up in income tax basis available to community property assets.

There are many ways to hold title to real property in California. We recommend you speak with an attorney before taking title or making a transfer to ensure you hold property in the best form for your particular circumstances.

CONSIDER MAKING YOUR ANNUAL GIFTS EARLY THIS YEAR

DeEtte L. Loeffler, J.D., LL.M. Taxation

While gift-giving is a common theme during the holidays, gifts can be made at any time during the year. For 2014, single people can make an annual exclusion gift of up to $14,000 to anyone without incurring a gift tax or having to file a federal gift tax return (and married couples can gift up to $28,000 from the assets of either spouse). This is a significant tax benefit that anyone, regardless of citizenship, can use.

There are a number of benefits from making your gifts early in the year. First, and most practically, you will not lose your opportunity to make gifts in 2014 if you make them early. If you were to become incapacitated, unless your estate plan allows your agents to make gifts of your assets on your behalf, it is unlikely you will be able to make any gifts at all. Likewise, if you were to pass away before making gifts, the opportunity would be lost.

Second, making gifts early in the year can increase the amount of the overall gift to the beneficiary. The “time value of money” means that a gift made early will have more time to grow. You can increase the value of the gift by making it through an intentionally defective grantor trust (an “IDGT”) that transfers beneficial ownership of the asset to a trust for the beneficiary. This allows you to pay the income taxes generated on the trust assets, thus increasing the value of the overall gift without increasing the transfer tax consequences to you. For example, if you were to make a $14,000 gift to a regular trust for your grandchild, and the gift earned 5%, the trust would owe federal and state income taxes of $360.50 on the $700 of income generated, resulting in the trust having a net of $14,339.50 after taxes. However, if you were to make the same gift to an IDGT, you would pay tax at your current rate (which is likely lower than 51.5% combined federal and state), and the trust would have $14,700 at the end of the tax year.

Third, making early gifts can be more economical for you. If you had appraisals prepared at the end of 2013 for making gifts of partial interests in an asset (e.g. real property), you can likely reuse those appraisals for gifts in early 2014. This can be a big savings as the cost of obtaining a discount appraisal continues to increase. Further, you (or your professional advisor) can likely reuse the 2013 transfer documents, which can be another cost saver.

Finally, if you think you will need Medicare down the road, making gifts now may help you to qualify for Medicare later, provided that the gifts are made early enough. Medicare imposes a 5-year waiting period for gifts, which means that if you make a “disqualifying gift” within five years of applying for benefits, you may have a waiting period before you can begin receiving benefits. Regular gifts made to a charity that show an intentional lifetime pattern of giving might not be disqualifying, but large irregular charitable gifts and gifts to family members will certainly be scrutinized to determine if they were done solely to permit the giver to receive benefits.

There are, of course, some possible detriments to early gifting. First, you might actually need the funds or assets later in the year. If this appears possible, don’t make the gift. It is also possible that you won’t have “extra” money available to help someone out in an emergency later in the year. It is advisable to always keep sufficient funds to deal with an emergency.

Overall, making early gifts can be a good decision. It helps you avoid losing your opportunity to use the annual exclusion for the year, can increase the overall value of the gift, and can save you money in the long run. If you have questions, or would like our assistance with making annual exclusion gifts in 2014, please let us know.

INHERITED IRA: GUIDANCE ON ITS FORMATION AND FUNDING

Bradford N. Dewan, J.D., MBA

When a spouse is named as the primary beneficiary of an IRA, the spouse will usually take advantage of the opportunity to roll over the funds from the deceased spouse’s IRA into an IRA held in the name of the surviving spouse. This process is relatively straightforward. However, this is not necessarily true when, for example, the children of the IRA owner inherit an IRA from a parent. This scenario will occur when the children are named as the “contingent beneficiaries” of the IRA and the spouse who was named as the “primary beneficiary” has predeceased the IRA owner. It can also occur when the IRA owner simply decides to name the children as the “primary beneficiaries” because the children, for example, are from a prior marriage. The process for forming and funding an "Inherited IRA account" ("Inherited IRA") can be complex and can actually vary somewhat from custodian to custodian. The following discussion attempts to highlight some of the key steps and information needed to form and fund an Inherited IRA.

<u>Step One: Contact the Custodian.</u> Upon the death of the IRA owner, the beneficiaries need to contact the custodian of the IRA to determine which process the custodian has established for creating and funding an Inherited IRA. The custodian will likely first want proof of the IRA owner's death and will thus ask for a death certificate issued by a local government agency.

<u>Step Two: Open the Inherited IRA.</u> Once the custodian has confirmed the death of the IRA owner, this custodian will require the beneficiary to open a new Inherited IRA account. To do this, the custodian will typically require that the beneficiary provide a photo ID and other documents confirming the identity of the person claiming to be the beneficiary of the decedent's IRA. It is very important to understand that this initial Inherited IRA will have to be established with the custodian of the decedent's IRA. Forming the Inherited IRA with the original custodian allows that custodian to communicate with the named beneficiaries of the IRA who are now the "owners" of the Inherited IRA. This also provides the custodian with information needed for appropriate reporting to the IRS for this account. Thus, even though the beneficiary may ultimately want to have the Inherited IRA with another custodian, the process can only begin with forming the initial Inherited IRA with the current custodian. This underscores the importance of communicating with the custodian of the decedent's IRA as soon as practical after his or her death.

<u>Step Three: Name of Inherited IRA.</u> One of the most important factors in forming the Inherited IRA is selecting the name of the Inherited IRA account. The Inherited IRA cannot simply be in the name of the beneficiary. Rather, the name must reflect that it is being funded with assets from the decedent's IRA with the acknowledgement that it is for the benefit of the named beneficiary. Consequently, while the IRS has not specified a form for the name, the name should include the names of both the decedent and the beneficiary. An example would be: "John Jones (Deceased) FBO Susan Jones, Inherited IRA". The consequence of not properly naming the Inherited IRA can be severe. For example, any funds transferred from the decedent's IRA to an account intended to be an Inherited IRA account which was not properly named could be treated by the IRS as a taxable distribution from the decedent's IRA.

<u>Step Four: Transfer of Funds to the Inherited IRA.</u> Generally, the owner of an IRA has the ability to transfer funds from one IRA account to another by taking a distribution from one IRA and contributing those funds to another IRA within sixty (60) days from the date on which the funds were withdrawn. If done within this 60 day window, the distribution from the first IRA will be treated as a nontaxable "rollover" to the second IRA account instead of a taxable distribution. However, this type of transfer is <u>not</u> permitted when funding an Inherited IRA. Rather, the funds from the decedent's IRA can only be transferred to the Inherited IRA by a "trustee-to-trustee" transfer. That is, the initial funding of the Inherited IRA will be accomplished by the custodian by simply reflecting the transfer of funds from the decedent's IRA to the Inherited IRA on its account records without any actual distribution to the beneficiary.

<u>Step Five: Create Separate Accounts.</u> If the IRA owner named more than one non-spouse beneficiary, then each individual beneficiary will have the ability to "stretch-out" the required distributions over his or her life expectancy if the formation and funding of his or her Inherited IRA is accomplished by a specified date. The Treasury Regulations require that each of the separate Inherited IRAs to be formed and funded by December 31st of the year following the death of the IRA owner. If this deadline is not met, the required distributions to each beneficiary may have to be based on the life expectancy of the eldest beneficiary. Thus, the youngest beneficiaries will be denied the ability to maximize the stretch-out of the required distributions.

Step Six: Commencement of Required Distributions from an Inherited IRA. While there is the potential for stretching-out the distributions from an Inherited IRA, the first distribution must be taken by December 31st of the year after the year of the death of the IRA owner. The amount of this distribution will be determined by taking the value of the account on December 31st of the previous year and dividing it by the life expectancy of the beneficiary listed in the IRS' "Single Life Table" rather than the table used by the former IRA owner (i.e. the "Uniform Lifetime Table"). The following year, and each year thereafter, that life expectancy is reduced by one year. In contrast, the former IRA owner would have gone to the Uniform Lifetime Table each year to determine the new life expectancy to be used in calculating the required distribution for that year.

The above may serve as a guideline for the steps needed to be taken by individual beneficiaries to form and fund Inherited IRAs and allow those beneficiaries to derive the greatest benefit from the Inherited IRA. A second article will describe the rules and processes that must be followed when a trust becomes the "designated beneficiary" of an IRA upon the death of the IRA owner and how such rules and processes differ from those described above when an individual is the "designated beneficiary".

STATE TAX NEWS: $16 MILLION IN REFUNDS NOT CLAIMED

Each year, the State of California has difficulty getting refunds to taxpayers who moved and failed to keep the Franchise Tax Board advised of their new address. In 2013, California received back over $16 million in refund checks. The majority of these refunds are for less than $1,000.00, but some 3,000 taxpayers are entitled to much larger returns. If you did not receive your refund or think you may be owed money by the Franchise Tax Board, you can make a refund request at:
https://www.ftb.ca.gov/online/refund/index.asp.

FEDERAL TAX UPDATE: LATE START TO FILING

The IRS will not begin accepting income tax returns from taxpayers until January 31, 2014. The delay will not extend the date on which income taxes have to be paid - that date remains April 15, 2014, although the tax returns themselves can be filed on extension if an appropriate request is filed. The government shut-down in October came at a critical time and caused the IRS to fall behind in updating tax forms. On January 14, 2014, the IRS, in conjunction with software companies, released its 2013 on-line tax filing programs for low-income tax payers. Those with income of less than $58,000.00 can prepare and file their returns for free by going to: IRS.gov/freefile.

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