BAD TIMES IN REAL ESTATE PROVIDE ESTATE PLANNING OPPORTUNITIES

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With real estate values down, it might be the time to take advantage of a bad situation!

Congress and the President have made it clear that estate tax reform is not on their agenda this year. This means that, at least for the remainder of 2009, you can continue to take advantage of the IRS's liberal gifting rules, which are one of the most effective means of preserving your family's estate. And this deflated economy has made it even more attractive.

Depressed real estate values provide an opportunity to substantially reduce your taxable estate by transferring depressed real estate to your heirs at current values. For example, this may be the best opportunity to transfer equity in the family cabin or ranch to your heirs while property values are down, knowing that the property is likely to substantially appreciate in the future.

Under current law, each person can gift as much as $1 million during his or her lifetime (in addition to the annual exclusion gifts, which are currently $13,000 per beneficiary, to an unlimited number of beneficiaries) without having to pay a gift tax. A significant benefit of an immediate gift of real estate during a recession (either outright or a partial interest) is that all future appreciation associated with the gift is removed from your eventual estate. Once the gift is made, the future value of the real estate is no longer relevant to determining estate taxes for the gifting person.

Another California law provides that individuals can transfer/gift up to $1 million in assessed value (in addition to a principal residence) of real estate to a child or parent without triggering reassessment. For property that has been owned for a long time, the assessed value is likely much lower than the current market value, so it is possible to transfer much more than $1 million in value without triggering reassessment or gift taxes. In this circumstance, property taxes to the children will not be increased as a result of the transfer/gift, other than the potential Proposition 13 minimal increase each year that will probably occur even if nothing is done.

When property values are low, there is a benefit to take advantage of the $1 million exclusion to gift up to a million dollars of real property specifically to your children. The children take the property at the existing assessed value, and the property is not reassessed for property tax purposes. If the gifting person wants to keep property in the family, this may be an advantageous time to do this where the children intend to hold onto family property and want to avoid reassessment for property taxes purposes while the parents are still living. Because of the current gift, the children's estate, not the parents' estate, will bear the appreciation.

Another option to consider in order to maximize the potential estate tax savings is to gift a fractional interest in real estate to your children while property values are low. Not only is the gifted portion passed to your children without being reassessed for property taxes, the remaining undivided fractional interest that is kept in the estate generally qualifies for a "valuation discount" for estate tax purposes (because the property is not wholly owned by the estate and is worth less on the market). This option might result in having your children eventually receive more of your real estate without having to pay estate taxes. With this approach, not only would your present gift qualify for a valuation discount to the child's estate, the parent's retained partial interest may be entitled to a discount for estate tax purposes at your death. Although current estate and gift tax legislation is being negotiated in Congress, a person gifting a fractional interest in real estate to a child will at a minimum remove future appreciation in the gifted portion from the parent's estate, and may allow the additional benefit of a valuation discount on the remaining portion of the estate at the time of the gifting parent's death.

If the overall goal is to have specific real estate stay in the family after your death, an immediate gift of up to $1 million in real estate to a child while property values are low is a great way to save estate taxes. As with most decisions, certain downsides exist, but they may be outweighed by your overall estate plan. Two factors to consider in your final determination include (1) ultimately, if and when the property is sold by your children or grandchildren, whether you are concerned that the seller will be responsible for capital gains tax on the original assessed value; and (2) whether it is important that your children will not receive a "stepped up basis" for the gifted real estate following the parent's death. However, because it is likely that property values will eventually appreciate and your estate will continue to rise, if a compelling concern is to keep certain parcels in the family to be enjoyed for future generations, the tax savings may far outweigh any negative consequences of holding onto all of your real estate and let your children worry about the taxes later!

If you have questions regarding this article or would like to review your estate plan, please contact Bill Davis at Trainor Fairbrook. You may reach Mr. Davis at (916) 929-7000 or by email at wdavis@trainorfairbrook.com.