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REAL ESTATE LAW AND ESTATE PLANNING UPDATE SUMMER 2011

Real Estate

Trees as a "Spite Fence". A decision just handed down this spring by the California Court of Appeal ruled that a row of trees planted by one neighbor constituted a "spite fence" under a seldom applied 1953 law.

The facts of the case (*Vanderpol v. Starr*) are somewhat unique, and likely do not have broad application to neighborly disputes, but the ruling nonetheless is important in that it expands the definition of a "structure in the nature of a fence" to include a row of trees serving as a barrier between adjoining properties. Once the court found that the trees were in the nature of a "fence", it then ruled that the Starrs' "malicious" behavior in maintaining (or failing to maintain) the trees resulted in compensable damages to the Vanderpols under the 1953 "Spite Fence Statute".

For more information about fence and boundary disputes, see my 1997 and 2005 Newsletters that are posted on my website, www.festalaw.com.

Estate Planning

Overview of the new law. The recently enacted 2010 Tax Relief Act, signed by President Obama in late December reduces estate, gift and generation-skipping transfer (GST) taxes for 2011 and 2012. It preserves the estate tax repeal for 2010, but in a roundabout way: estates wanting zero estate tax for 2010 must elect that option, along with the less favorable modified carryover basis rules that were set to apply for 2010. Otherwise, by default, the estate tax is revived for 2010, with a \$5 million exemption, a top tax rate of 35%, and a step-up in basis. Also, for estates of decedents dying after Dec. 31, 2010, a deceased spouse's unused exemption may be shifted to the surviving spouse. However, these generous rules are temporary—much harsher rules are slated to return after 2012. For 2011 and 2012, the 2010 Tax Relief Act reduces the top rate to 35%. It also increases the exemption to \$5 million for 2011 with a further increase for inflation in 2012. But these changes are temporary. After 2012, the top rate will be 55%, and the exemption will be \$1 million.

Special tax saving choice for 2010. The 2010 Tax Relief Act allows estates of decedents who died in 2010 to choose between (1) estate tax (based on a \$5 million exemption and 35% top rate) and a step-up in basis, or (2) no estate tax and modified carryover basis. Basis is the yardstick for measuring income tax gain or loss when an asset is sold. With a step-up in basis, pre-death gain is eliminated because the basis in the heir's hands is increased to the date of death value of the asset. On the other hand, with a modified carryover basis, an heir gets the decedent's original basis, plus or minus certain increases or decreases. If the decedent had a relatively low basis and significant assets, some pre-death gain may be taxed when the heir sells the property. These concerns factor into the special choice for

2010. The executor should make whichever choice would produce the lowest combined estate and income taxes for the estate and its beneficiaries. This would depend, among other factors, on the decedent's basis in the assets immediately before death and how soon the estate beneficiaries may sell the assets.

Gift tax changes. Years ago, the gift tax and the estate tax were unified—they shared a single exemption and were subject to the same rates. This was not the case in recent years. For example, in 2010, the top gift tax rate was 35% and the exemption was \$1 million. For gifts made after Dec. 31, 2010, the gift tax and estate tax are reunified and an overall \$5 million exemption applies.

GST tax changes. The GST tax is an additional tax on gifts and bequests to grandchildren when their parents are still alive. The 2010 Tax Relief Act lowers GST taxes for 2011 and 2012 by increasing the exemption amount from \$1 million to \$5 million (as indexed after 2011) and reducing the rate from 55% to 35%.

New portability feature. Under the 2010 Tax Relief Act, any exemption that remains unused as of the death of a spouse who dies after Dec. 31, 2010 and before Jan. 1, 2013 is generally available for use by the surviving spouse in addition to his or her own \$5 million exemption for taxable transfers made during life or at death. Under prior law, the exemption of the first spouse to die would be lost if not used. One way to address that was to set up a by-pass or credit shelter trust. Now, the portability rule may make setting up such a trust unnecessary in some cases. But there still may be other reasons to employ credit shelter trusts. For example, a credit shelter trust may protect appreciation occurring between the death of the first spouse and the death of the second spouse from being subject to estate tax. Such a trust also can protect against creditors. Plus, the transferred exemption may be lost if the surviving spouse remarries and is again widowed. Finally, the uncertain changes that are set to occur in 2013 and/or beyond may again require the funding of such trusts.

Conclusion. The estate tax relief in the new law is substantial, but it is temporary. Estate planning to reduce taxes remains an important consideration. Even if taxes are not a concern because an estate is below the exemption level, it is still important to have a proper estate plan to ensure that the needs of intended beneficiaries are met.

--Michael J. Festa is a graduate of the UCLA School of Law, and has been practicing in Santa Monica since 1979. His practice focuses primarily on real estate, business, estate planning and probate matters, and all related litigation.

--The above discussion is not intended as legal advice and cannot be relied upon for any purpose without the services of a qualified professional.

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--Visit our website, www.festalaw.com, for more information about the firm, as well as some of our newsletters from previous years. Or, contact Mr. Festa directly by phone or at mike@festalaw.com.