



# ESTATE PLANNING QUARTERLY REPORT

THE LAW OFFICES OF BORTON PETRINI, LLP

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## *Is Estate Planning Necessary?*

By John F. Petrini

Thinking about your own death is neither a fun nor pleasant subject, but it must be broached at some point in everyone's life. To better prepare yourself for the inevitable, you should prepare an estate plan. An estate plan is more than a will. It is a well thought out plan for carrying out your wishes after you pass away. It should accomplish the goals and priorities you set, whether that is providing for loved ones, passing on wealth to the next generation, or achieving philanthropic objectives.

There are other benefits to a good estate plan, such as minimizing or eliminating estate taxes, reducing or eliminating probate costs, preventing the erosion of assets because of inflation, and avoiding costly litigation among heirs who don't get along.

### WHAT ELEMENTS MAKE UP AN EFFECTIVE ESTATE PLAN?

#### **The Living Trust**

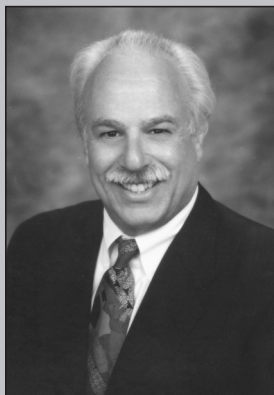
We recommend that everyone have at least a living trust, also called a revocable trust. It is a good first step. This will give you a chance to decide to whom and how your property will be divided. At this point, you will also be able to decide on a personal representative, appoint guardians for minor children, minimize fees, reduce or eliminate estate taxes, and avoid conservatorship, if that becomes necessary.

#### **Advanced Health Care Directive**

You will also want to create an advance health care directive, which becomes effective if and only if you are somehow unable to speak on your own behalf. It also allows you to

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## *John F. Petrini*



John F. Petrini is a Partner in the Bakersfield office of Borton Petrini, LLP. He has been an attorney for over 30 years and is AV rated by Martindale-Hubbell. He is experienced in estate planning, trust administration and probate. His particular expertise in business contracts and business disputes gives him a unique perspective in this area. He has spoken to groups in the area about estate planning and keeps up in the field by his attendance at advanced estate planning institutes. He is the editor of the Estate Planning Quarterly Report.

Mr. Petrini served as President of the Kern County Bar Association (1987), and sits on the board of the Petroleum Club of Bakersfield and the Southern San Joaquin Emmaus Group.

## QUALIFIED PERSONAL RESIDENCE TRUSTS

By Grant W. Peters

A Qualified Personal Residence Trust (“QPRT”) is a trust that allows a homeowner (“Grantor”) to transfer his or her residence to family members, as of some date in the future. QPRTs can also be used to transfer a vacation home or a second residence. The Grantor transfers a future interest in the residence to the QPRT and continues to live there until the QPRT terminates. If the Grantor is still alive when the QPRT terminates, the residence is transferred to the designated family members. The Grantor often continues to live in the residence after the end of the QPRT, but careful attention to details, such as payment of market rate rent, is required to avoid invalidating the gift for estate tax purposes.

Why not just make a gift of the residence now? The advantage of the QPRT is that the value of the future interest transferred is usually significantly less than the actual value of the residence. This can result in a substantial gift or estate tax saving. Also, any accumulated appreciation during the term of the QPRT is outside the Grantor’s estate, provided the Grantor lives to see the residence distributed to the family.

For example, a \$600,000 residence that is transferred through a QPRT might use only \$350,000 of the Grantor’s gift tax exemption. With property appreciating over time, the family could receive a home valued at over a million dollars when the QPRT terminates. Thus, an asset valued at over \$1 million at the time of death is out of the estate at a value of \$350,000, saving the \$460,000 or more in estate taxes that would have been due if the residence had remained in the estate.

One of the drawbacks of the QPRT is that the residence does not receive a new tax basis on the Grantor’s death. When the residence is ultimately sold, capital gains taxes may need to be paid. But the capital gains tax rate is currently much less than the estate tax rate.

Another drawback is that the residence remains in the Grantor’s estate if the Grantor dies before the date set for termination of the QPRT. In that case, the gift tax exemption used on formation of the QPRT is returned to the estate.

Estate taxes can be substantial. Where an individual’s estate exceeds \$2 million, the current estate tax rate is 46% of the amount in excess of \$2 million. For a \$3 million estate, this could mean \$460,000 in estate taxes. A QPRT is one of several advanced methods of transferring property out of a large estate in order to reduce the estate taxes that

will ultimately be payable on the death of the owner. Other strategies include: life insurance trusts for the benefit of the Grantor’s family; Grantor Trusts that allow assets to accumulate and grow outside the estate of the Grantor for the benefit of the Grantor’s family; and various charitable trusts that provide a current income tax deduction, distribute income to the Grantor and his or her spouse, and avoid estate tax when the remainder in the trust goes to the charity designated by the Grantor upon the death of the Grantor or other income recipient.

A QPRT can be a powerful tool to help reduce or avoid estate taxes in a proper situation. Although QPRTs and other tax avoidance tools can be relatively complex, the estate tax savings can be huge. Our office is available to advise clients who want to explore the ways they can reduce or eliminate estate taxes and probate fees. ❖

### Grant W. Peters



Grant W. Peters is an attorney in the Bakersfield office of Borton Petrini, LLP. He received his undergraduate degree in Chemistry and his M.D. from Loma Linda University. He earned his J.D. at University of California, Berkeley, Boalt Hall School of Law. Grant also holds an M.S.A. in Healthcare Administration.

Grant’s primary areas of emphasis at Borton Petrini, LLP are health care law, business organizations and estate planning.

Grant’s estate planning practice focuses on helping individuals and families develop a realistic plan for their assets that benefits the people and causes that are important to them. Many plans include asset protection and tax reduction strategies; others simply assure that assets are passed to the designated family members at the appropriate time. An important part of each plan is planning for the possibility of infirmity, ill health, or accidental injury.

**DISCLAIMER: THE INFORMATION PROVIDED IN THIS UPDATE IS NOT A SUBSTITUTE FOR LEGAL ADVICE. READERS SHOULD BE ADVISED THAT IF THEY HAVE QUESTIONS ABOUT THIS OR ANY OTHER AREA OF ESTATE PLANNING, THEY SHOULD SEEK THE ADVICE OF COMPETENT COUNSEL SPECIALIZING IN ESTATE PLANNING.**

## IS ESTATE PLANNING NECESSARY?

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specify the kind of medical care you wish or wish not to receive in a life-threatening situation.

### Durable Powers of Attorney

You will also want to create durable powers of attorney for financial matters. Again, appoint someone to act on your behalf if you were unable to do so yourself. This document would allow you to dictate his or her actions for you.

## YOU'VE MADE YOUR ESTATE PLAN, NOW WHAT?

Finally, make sure and change your living trust as circumstances in your life change. Nothing is sedentary, things change constantly, and you need to be aware of how these changes affect your estate. Children or grandchildren are born, needs and concerns change (especially as you and your loved ones get older), loved ones pass on.

As these things happen, your wealth may ebb and flow. Tax laws change as well. All these are pertinent reasons to review and update your trust. You can change your trust at any time by executing an amendment to your trust.

### HOW ELSE CAN YOU MAKE SURE YOU HAVE A STRONG AN EFFECTIVE ESTATE PLAN?

First, make sure you know whom you want to benefit. Make sure to list their full names, ages, relationships, domicile, family, and financial situations. Then decide what you want to give them, whether it is a set amount or percentage of your estate.

Secondly, you will want to list the charitable organizations that you wish to see benefited now and by your trust. Charitable and life-income gifts are an important part of many estate and retirement plans. If this is an avenue you would like to explore, you will find there are several advantages that come with charitable gifts, not just a warming of the heart, but also tax benefits.

Be sure to review life insurance and pension plan beneficiaries and payment options. These are typically paid directly to the named beneficiaries without any legal proceedings unless your estate, or any trustee thereof, is named.

You will also want to maintain updated and detailed records of your assets and debts. Make sure you are aware of cost basis and holding periods for your assets and keep track of your mortgages, loans, and taxes. Keep a close inventory of where these documents are located and tell your executor where the list can be found.

In addition to all this, it may be prudent to consider lifetime transfers of assets. Consistently utilizing the gift tax exclusion is an excellent way to transfer assets to family members without a gift tax bite or use of the \$1 million life-time gift tax exemption.

This year, Congress raised the annual gift tax exclusion to account for inflation. Effective as of the beginning of 2006, you can give \$12,000 annually (up from \$11,000) in cash or assets to anyone you would like, they need not be family, without filing a gift tax return or paying a gift tax. The value of the gift is not income to those you wish to bestow it upon, but they must include the asset's earnings in their gross income.

A married couple may combine their exclusions and give up to \$24,000 to as many people as they wish annually. This is, of course, without paying gift tax or using their lifetime exemptions.

Each person also can gift up to \$1,000,000 (not including gifts to charities) in his or her lifetime without paying a gift tax, although you will have to file a gift tax return if the gift is over \$12,000 in 2006. Gifting is an excellent way to lock out appreciation from your estate and eliminate possible estate taxes on the gifted asset. Gifts, however, must be complete to be effective.

Tuition and health care payments you make on behalf of another person are not considered taxable gifts. Therefore, this exclusion is in addition to the annual \$12,000 exclusion. The payments must be made directly to the school or medical care provider.

Additionally, the gifts that qualify for the \$12,000 annual exclusion do not reduce the generation-skipping transfer exemption nor will they be affected by the GST or estate taxes.

These gifts may also be made using a durable power of attorney. The authorization may specify to whom the gifts are made and limit the amount of each gift. Your attorney-in-fact can also be authorized to make charitable gifts and fulfill charitable pledges using this tax exclusion.

A note of caution regarding the annual tax exclusion: be wary when making end of the year gifts by check or giving securities because the gift must be completed in the same year you wish for it to qualify for the annual exclusion. Make sure to not overlook any gift or tax laws when making gifts to family members and others.

Thinking about a future of which you might not be a part is uncomfortable for anyone to imagine. But knowing that you are prepared for whatever lies ahead is prudent, responsible, and allows for peace of mind. It is not just for your sake, but also that of your family. An effective estate plan can save on headaches as well as taxes. As always, to learn more about these strategies as well as how they apply to your personal situation, consult your advisor. ❖

*“Children or grandchildren are born, needs and concerns change . . . loved ones pass on. . . . All these are pertinent reasons to review and update your trust.”*

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