BROWN & STREZA LLP
Attorneys at Law

ESTATE PLANNING
BUSINESS PLANNING
INCOME TAX PLANNING
CHARITABLE SECTOR
MERGERS & ACQUISITIONS

Using Your Five Million - Now or Later?

David Keligian
Partner

Written By: David Keligian, J.D., M.B.A., CPA
Written on 10/28/2011
https://www.brownandstreza.com/Home/AttorneyBlogs.aspx

Using Your Five Million - Now or Later?

The $5,120,000 per person gift tax exemption is supposed to last until December 31, 2012. Why use it now if you still have next year? Here are two good reasons.

The first is that given our country's economic and fiscal situation, the Joint Select Committee on Deficit Reduction, also known as the "Supercommittee", may reduce the gift tax exemption sooner than 2012. At least half the members of the committee are insisting on tax increases as part of the deficit reduction "solution". (As one wag put it, where do all the "solutions" go after politicians get elected?)

The Obama administration has not only proposed tax increases in its jobs bill, but is also calling for a return of the estate and gift tax rates and exemptions to their 2009 levels. That means an estate tax exemption of $3,500,000 per person, but a gift tax exemption of only $1,000,000 per person. So it is possible a significant reduction in the current $5,120,000 gift tax exemption could occur sooner than the end of 2012.

This is important because advanced estate planning relies much more on using the gift tax exemption than the estate tax exemption. Using the gift tax exemption permits you to "leverage" (magnify) the value of assets that are transferred for every given dollar of available exemption, as well as shift future appreciation out of your estate. By contrast, the estate tax exemption is much less powerful—it is applied dollar for dollar against the value of assets owned at death, and much more difficult to "leverage".

The second reason relates to the concept of "leverage". Instead of changing the exemption amount, the Supercommittee may instead propose eliminating some of the advanced planning techniques which provide you with leverage. One possibility is reducing or eliminating valuation discounts for transfers of closely held business interests to family members. Such changes could cost taxpayers much more than simply reducing estate or gift tax exemptions. Since the Supercommittee is supposed to present legislation that can be voted upon by Congress prior to year end, waiting until 2012 might be very expensive.

In using your $5,120,000 exemption, timing can be everything. Given the potential savings available, careful consideration should be given to the best way to maximize the exemption and when it should be used.

16. Driver's license of taxpayer;
17. Driver's license of taxpayer's spouse;
18. Voter registration and actual voting;
19. Charge accounts;
20. Predominant banking and financial accounts;
21. Accountant, lawyer, and professional advisors;
22. Wills prepared and located;
23. Education of children;
24. Majority of time spent in that State;
25. Country club membership;
26. Intended state of residence;
27. Presence of, and visits by, other family members;
28. Social event attendance; and
29. Professional memberships.

PROBLEM WITH THE FACTORS. Unfortunately, the Corbett factors are sometimes relied on as a defense in circumstances where the taxpayer actually spends most of their time in California. For example, it won't matter if you have your tax returns prepared in Nevada, get a Nevada driver's license, join a country club in Nevada, and buy a condo in Las Vegas if the Franchise Tax Board is still able to show that you spend more time in California.

The Franchise Tax Board will do internet searches and review charge card receipts to see where you're actually spending your time. Having a Nevada cell phone number and your mailing address at a Las Vegas condo will do you no good if your charge card receipts show you are constantly buying things in Fashion Island, the Spectrum shopping center, or nice restaurants near your Laguna Beach beach house.

BUSINESS SALES. The question of changing residency sometimes comes up in situations involving the sale of a substantial business. Let's assume, for example, that you have a business which will be sold for $20,000,000 and it's conducted by a Nevada S-Corporation, but most of the business assets and operations are in California.

Under these circumstances, the only way California taxes can be saved by a change in your personal residency is if you sell the stock of the S-Corporation after you are no longer a California resident. Unfortunately, even if you do validly change your residence to another state, if (as most buyers prefer) the assets of the S-Corporation are sold, there will be California-source income from the sale. That California-source income will be taxed by California at the S-corporation level and will also flow through the S-Corporation and be taxed by California to you individually, even if California agrees you changed your residency.

IT CAN WORK. Under the right circumstances, especially in the context of a major business sale, a change in residency can save substantial California taxes. However, it must be planned for and analyzed correctly from the beginning.

In addition, you must be prepared to actually leave and stay out of California for the sale year and some time thereafter, since the state can still make an argument that someone who leaves for only several years to avoid tax from a major sale still kept their California "domicile". Thus, someone planning to end their California residency should understand the rules, the steps required, and the practicalities of the entire process.

Tel (949) 453-2900
Fax (949) 453-2916
Email: Inquiries@BrownandStreza.com
www.brownandstreza.com

BROWN & STREZA LLP
40 Pacifica
15th Floor
Irvine, CA 92618