PROSKAUER ROSE LLP

Personal Planning Strategies

A report for clients and friends of the firm.

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In this issue:

January 2009 Update – Many Exemptions Increased With Respect to Federal Estate, Gift and GST Taxes

As we reported in our earlier issues of Personal Planning Strategies, the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Act") made significant changes to the federal estate, gift and generation-skipping transfer ("GST") taxes.

Federal Estate Tax in 2009

The federal estate exemption increases from $2 million in 2008 to $3.5 million in 2009. This means that if an individual dies in 2009, he or she can transfer up to $3.5 million (less taxable gifts made during his or her life) without paying any federal estate tax.

Married couples should structure their estate plans so that both spouses utilize their exemptions, thereby shielding up to a total of $7 million from federal estate tax. For example, as discussed below, by using a "bypass trust" and properly dividing their assets, both spouses can utilize their federal estate tax exemptions. A "bypass trust" is drafted in a manner that allows assets to "bypass" the federal estate tax that otherwise would be imposed when the second spouse dies.

Without proper estate planning, a spouse may waste his or her federal estate tax exemption. For example, suppose John and his wife, Jill, live in Florida and have a total of $7 million (each has $3.5 million of assets in his or her own name). Assume John dies and leaves $3.5 million to Jill under his Will (or his revocable trust). John's estate does not have to pay any federal estate tax because the assets that pass to Jill qualify for the unlimited marital deduction. When Jill dies, her estate will be worth $7 million ($3.5 million from John's estate plus her own $3.5 million). Jill's estate can utilize her $3.5 million exemption, but John's $3.5 million exemption will have been wasted. Accordingly, Jill's estate would be subject to federal estate tax of $1,575,000.

With proper estate planning, both spouses can utilize their federal estate tax exemptions. For example, John's Will (or his revocable trust) could direct that $3.5 million be held in a "bypass trust" for the benefit of Jill, and on Jill's death, the remaining assets would pass to their children. Under this example, John's estate could utilize his federal estate tax exemption by funding the "bypass trust" with $3.5 million and Jill's estate could utilize her exemption upon her death. Under this plan, John and Jill could pass $7 million to their children free of any federal estate tax, resulting in tax savings of $1,575,000. In addition, any appreciation on the assets in the bypass trust after Jill's death would also not be subject to estate tax.

Having a Will (or revocable trust) that includes a bypass trust is only the first step. To ensure that the bypass trust can be funded, there are two important considerations. First, each spouse should own sufficient assets in his or her individual name to fund the bypass trust. This means that in 2009, in order to fully fund the bypass trust, each spouse should have at least $3.5 million of assets in his or her individual name. Second, it is important to identify which assets pass under the Will (or revocable trust) and which assets pass outside of the Will (or revocable trust). For example, certain assets, such as Individual Retirement Accounts, typically pass outside of the Will (or revocable trust) by beneficiary designation and in that event, would not be available to fund the bypass trust. Careful estate planning is required to ensure that such assets are available to fund the bypass trust if necessary.

The top Federal estate tax rate remains at 45% in 2009.

The Future of the Federal Estate Tax

Under current law, the federal estate tax is scheduled to be repealed in 2010. In 2011, the federal estate tax is scheduled to return with a $1 million exemption.

President-elect Obama opposes the scheduled federal estate tax repeal. His tax plan proposes to freeze the federal estate tax levels set for 2009, meaning that the federal estate tax exemption would remain at $3.5 million and the top federal estate tax rate would remain at 45% in 2010 and beyond.

Generation Skipping Transfer Tax

Like the federal estate tax exemption, the federal generation skipping transfer ("GST") tax exemption increases from $2 million in 2008 to $3.5 million in 2009.

Generally speaking, the GST tax applies when a person transfers property to someone who is at least two generations younger than the transferor (or to a trust which eventually benefits such individual). The GST tax is designed to tax the transfer of property which effectively "skips" one or more intervening generations.

For example, if a grandparent makes a gift to a grandchild (or to a trust for children which ultimately will be distributed to grandchildren), that gift would be subject to the GST tax since the gift "skips" a generation. In 2009, a grandparent can make gifts or bequests of up to $3.5 million, in the aggregate, to his or her grandchildren (or trusts for their benefit) free of GST tax.

The GST tax is imposed in addition to the estate or gift tax. In 2009, the top GST tax rate remains at 45%.

Gifts

Unlike the increased federal estate tax and GST exemptions described above, the federal lifetime gift tax exemption remains at $1 million in 2009. This means that an individual may make gifts (in excess of the annual gift tax exclusion amounts and direct payments of education and medical expenses to the providers) of up to $1 million, in the aggregate, during his or her life before having to pay any gift tax. In 2009, the top gift tax rate remains at 45%.

Unlike the federal estate tax, the federal gift tax is not scheduled to be repealed in 2010. Rather, in 2010, the top gift tax rate is scheduled to equal the top individual income tax rate (currently 35%) and the federal lifetime gift tax exemption is scheduled to remain at $1 million in 2010.

The gift tax annual exclusion increases from $12,000 ($24,000 in the case of a married couple) in 2008 to $13,000 ($26,000 in the case of a married couple) in 2009.

For gifts made to a spouse who is not a citizen of the United States, the gift tax annual exclusion increases from $128,000 in 2008 to $133,000 in 2009 (unlimited gifts are allowed between spouses when both are U.S. citizens).

Annual exclusion gifts should always be made early in the year. If an individual dies during the year without making his or her annual exclusion gifts, the opportunity is lost. For every $13,000 gifted, almost $6,000 of federal estate tax could be saved. Moreover, making a gift early in the year of property that is likely to increase in value will remove the appreciation from your estate, thus avoiding gift tax on any post-gift appreciation.

Summary of Current and Future Rates and Exemptions

The table below summarizes changes in the federal estate, gift and GST taxes in 2009 and 2010, when the estate tax is scheduled for repeal (before being reinstated in 2011).

Most estate planning commentators think that Congress is likely to pass legislation after President-elect Obama takes office so that the estate tax is not repealed in 2010 but is reformed with exemptions and tax rates at least equal to the amounts that will come into effect in 2009, as set forth above.

We are also monitoring a proposal that would effectively disallow valuation discounts of closely-held interests such as family limited partnerships. Under current law, minority interest and lack of marketability discounts typically reduce the fair market value of assets involved in intra-family transactions by 30%. The IRS previously has expressed its desire to change the law to eliminate or reduce such discounts. With the Democratic party soon to control the White House and Congress, there is renewed concern that the proposed change in the law may take effect thereby eliminating or reducing such discounts.

Calendar Year	Top Federal Estate and Gift Tax Rate	Federal Estate Tax Exemption	Federal GST Tax Exemption	Federal Gift Tax Exemption
2009	45%	$3.5 million	$3.5 million	$1 million
2010	Gift Tax Rate Equals Top Individual Income Tax Rate (35%)	Estate Tax Repealed	GST Tax Repealed	$1 million
2011	55%	Estate Tax Returns With $1 Million Exemption	GST Tax Returns With $1,060,000 Exemption Plus Inflation Adjustment	$1 million

State Estate Taxes

In 2009, certain states, including California and Florida, continue not to impose a state estate tax. Other states, including Connecticut, New York, Massachusetts and New Jersey continue to impose a state estate tax. In 2009, the combined top federal and New York estate tax rate remains at 53.80%.

	Top State Estate Tax Rate	Maximum Federal Exemption for 2009 Allowable by States	Federal Estate Tax Exemption for 2009
California	0%	N/A	$ 3,500,000
Connecticut	16%	$2,000,000	$ 3,500,000
Florida	0%	N/A	$ 3,500,000
Massachusetts	16%	$ 1,000,000	$ 3,500,000
New Jersey	16%	$ 675,000	$ 3,500,000
New York	16%	$ 1,000,000	$ 3,500,000

As illustrated in the following charts, the estate of a decedent dying in 2009 with a $3.5 million estate would pay no federal estate tax, since the federal estate tax exemption is $3.5 million. If the decedent were a resident of California or Florida, his or her estate would not pay state estate tax either.

Year of Death	Value of Gross Estate	Federal Estate Tax	California Estate Tax	Florida Estate Tax
2009	$3,500,000	$0	$0	$0

However, if the decedent were a resident of Connecticut, Massachusetts, New York or New Jersey, his or her estate would have to pay a $229,200 state estate tax since those states do not conform to the federal changes. Therefore, whether or not a state follows the federal estate tax changes introduced by the Act can affect the total amount of estate taxes due.

Year of Death	Value of Gross Estate	Federal Estate Tax	Connecticut Estate Tax	Massachusetts Estate Tax	New York Estate Tax	New Jersey Estate Tax
2009	$3,500,000	$0	$229,200	$229,200	$229,200	$229,200

The amount of state estate taxes due becomes substantial in large estates. In 2009, the estate of a decedent with a taxable estate of $15 million will pay federal and state estate taxes totaling $6,201,740 if the decedent were domiciled in Connecticut, Massachusetts, New Jersey or New York but only $5,175,000 if the decedent were domiciled in California or Florida.

Accordingly, individuals with a residence in Connecticut, Massachusetts, New Jersey or New York and a second residence in California or Florida should consider establishing their primary residence in California or Florida.

How Can You Avoid Death Taxes In A State Where You Are Not Domiciled?

If the determination is made that there will be death taxes owed to a state where real or tangible personal property is owned (*i.e.,* a state other than the state in which you reside), there are steps that can be taken to eliminate tax in such state.

Since only real or tangible personal property (*i.e.,* residences, furnishings, boats, etc.) is subject to death taxes in the state where the property is located, converting those assets into intangible assets may avoid the state death taxes in those states. Therefore, you should consider transferring out-of-state assets to a partnership, limited liability company (LLC) or corporation and retaining an interest in the entity as a partner, member or shareholder, respectively. For example, if you are a Florida resident who owns a second home in New York, you can transfer your New York home to an LLC and retain ownership of that new LLC. Upon your death, your estate only owns an interest in an LLC, which is an intangible asset, and thus should not be subject to New York estate tax. It is important that a transfer to an LLC is not deemed a nominee or sham that could be disregarded. Accordingly, it is important to consult a qualified attorney in the jurisdiction in which the property is located before making any transfers.

Another option is to gift the real or tangible property during life to the ultimate recipient. If the property continues to be used by the donor, he or she should enter into an arms-length rental agreement with the donee with respect to the gifted property.

If you have questions pertaining to a particular state's death tax regime and how ownership of property in such state may affect your estate plan and potential death taxes, please do not hesitate to contact us.

Year End Planning Strategies

As you look back upon this year, and forward to the next one, you undoubtedly will experience some degree of anxiety. You could not control all of the forces that led to the financial crisis. You cannot yet determine how the Obama administration will address the nation's economic predicament. However, you can take charge of your family's future with these year end planning strategies.

Take Advantage of Low Interest Rates and Valuation Discounts

The combination of depressed asset values and low interest rates that currently exists renders this a perfect time to implement wealth transfer strategies that are designed to exploit those circumstances. Several techniques rely on investment returns that outpace the interest rates that are set by the Internal Revenue Service. Therefore, you should discuss with us, now, how intra-family loans, sales to intentionally defective grantor trusts, grantor retained annuity trusts and charitable lead annuity trusts can enable you to pass assets to the next generations at the lowest possible transfer tax cost (please see our June, 2008 issue of Personal Planning Strategies, available on our website, for more details about those estate planning strategies).

Moreover, there exists some concern that a Democrat controlled White House and Congress could pass legislation that would effectively eliminate valuation discounts of closely-held interests such as family limited partnerships. Currently, the appraisals required as evidence of the fair market value of assets involved in intra-family transactions can take into account minority interest and lack of marketability valuation discounts. Typically, those discounts reduce the asset value by 30%. Under a fairly recent proposal, the purchase price or gift tax cost of intra-family transactions would be increased by that 30% discount that would no longer be permissible.

There is no certainty that the law will change, but, if you have been considering a plan to give or sell interests in a closely-held business or family limited partnership to your family members, this may be the most favorable time to move forward with it.

Exploit the Gift Tax Annual Exclusion Amount

In 2008, the gift tax annual exclusion amount per donee remains $12,000 for a single person and $24,000 for a married couple who agree to "split" their gifts. In 2009, those amounts will rise to $13,000 and $26,000, respectively. If you have not already done so, now is the time to take advantage of this year's opportunity to make gift-tax free transfers so that you can ensure that they are "completed" before December 31, 2008.

You can increase the ultimate value of your gifts by finding that silver lining surrounding the economic storm that recently devalued many of your holdings. In lieu of cash gifts, consider gifting securities or interests in privately held companies or other family-owned entities. The assets that you give away, now, are likely worth significantly less than they were at the beginning of the year and hopefully will increase in the future. So that $24,000 gift that your spouse and you make today has a built-in discount that the Internal Revenue Service cannot reasonably question and that will eventually inure to the benefit of your beneficiaries when our economy rebounds.

Your annual exclusion gifts may be made directly to your beneficiaries or be made to trusts that you establish for their benefit. It is important to note, however, that gifts to trusts will not qualify for the gift tax annual exclusion unless they have certain, limited rights to the gifted assets; commonly known as "Crummey" withdrawal powers. If you have created a trust that contains beneficiary withdrawal powers, it is essential that your Trustees send Crummey letters to the beneficiaries whenever you (or anyone else) make a trust contribution (for a more detailed explanation on Crummey withdrawal powers, please see our December, 2004 issue of Personal Planning Strategies, available on our website). If you have created an insurance trust, remember that premium payments for insurance owned by the trust are considered additions to the trust. As a result, Crummey notices must be sent when those payments are made, as well. It is essential that withdrawal rights actually be exercisable in order for your gifts to qualify for the gift tax annual exclusion. The Crummey notices ensure that the gifts do so qualify.

2008 Gift Tax Returns

Gift tax returns for gifts that you made in 2008 are due on April 17, 2009. You can extend the due date to October 15, 2009 on a timely-filed request for an automatic extension of time to file your 2009 income tax return, which also extends the time to file your gift tax return. If you created a trust in 2008, you should direct your accountant to elect to have your generation-skipping transfer ("GST") tax exemption either allocated or nor allocated, as the case may be, to contributions to that trust. It is critical that you not overlook that step, which must be taken even if your gifts do not exceed the annual gift tax exclusion and would, therefore, not otherwise require the filing of a gift tax return. You should call one of our attorneys if you have any questions about your GST tax exemption allocation.

Achieve Your Altruistic Goals with IRAs

Wealthy individuals often have individual retirement accounts (IRAs) that they do not require to support their lifestyles during retirement. Moreover, upon your death, the value of your IRA may be greatly reduced by the imposition of both estate taxes in your estate and income taxes charged to your beneficiaries when they are required under current law to withdraw funds. However, if you are over age 70 ½ and are charitably inclined, the Pension Protection Act of 2006 contains a provision that enables you to reduce the value of your IRA without incurring any income tax liability. You may make tax-free IRA transfers of up to $100,000 annually to one or more qualified charitable institutions so long as you do so before year's end. It is important to note that the funds must be transferred directly from your IRA to the charitable beneficiaries; they cannot be distributed to you, and then by you to those beneficiaries. That provision (which is discussed in more detail elsewhere in this Newsletter) had expired after 2007, but Congress recently extended it through December 31, 2009.

Take your IRA Required Minimum Distributions

If you are a traditional IRA owner, you must begin to receive required minimum distributions ("RMDs") from your IRA and, subject to narrow exceptions, other retirement plans, by April 1 of the year after you turn 70 ½. Subsequently, you must receive those distributions by December 31 of each year. If you are the current beneficiary of an inherited IRA, you must also take RMDs by December 31 of each year regardless of your age. The RMDs must be separately calculated for each retirement account that you own, and you, not the financial institution at which your account is held, are ultimately responsible for making the correct calculations. The penalty for not withdrawing your RMD by December 31 of each year is an additional 50% tax on the amount that should have been withdrawn but was not. Please consult us if you need assistance with your RMDs.

Review Your Current Estate Plan

In 2009, the Federal estate and GST tax exemption amounts will rise to $3,500,000. That is $1,500,000 more than today's exemption amounts. The transfer tax regime is currently in flux due to the sunset provisions under current law that result in a one-year repeal of the estate tax in 2010, followed by a return of the tax in 2011 with a $1,000,000 exemption amount. However, it is anticipated that 2009 will bring with it legislation that makes the $3,500,000 estate and GST tax exemptions more permanent. Given the exemption amount changes that are scheduled to come into effect and the uncertain future of the transfer tax regime, it is now more vital than ever to review your wills, revocable trusts and other documents to ensure that they actually will be successful in achieving your estate planning goals.

For instance, do they account for the differences between the Federal and state laws (that are discussed in more detail elsewhere in this Newsletter)? If you reside in a state such as New York, which imposes a tax based on a significantly lower exemption amount than that afforded under the Federal regime, and you do not have a will that adequately plans for that difference, your estate could unnecessarily owe $229,200 in state estate taxes.

Another consideration is how you previously may have planned to utilize your Federal estate tax exemption amount. For instance, does your 2002 plan to bequeath to your children an amount equal to the Federal exemption amount of $1,000,000 still make sense now that the exemption amount is about to rise to $3,500,000?

Even if you remain satisfied with the provisions in your current estate planning documents, do each of your spouse and you hold individual title to sufficient assets to utilize the increased exemption amounts? If not, any plan to pass to your heirs, tax-free, your combined exemption amounts – in 2009, $7,000,000 – is likely to fall short of your expectations.

If you have not recently updated your estate plan or considered the strategies discussed in this article, we encourage you to call us and to do so now.

$700 Billion Financial Bailout Bill Permits Lifetime Charitable Gifts From Individual Retirement Accounts

The recent $700 billion Financial Bailout Bill has received a significant amount of press since it became law. In addition to the bailout, the new law provides for certain tax relief including a welcome change to the rules regarding lifetime contributions of IRAs to charity, which will benefit both individuals and charities. The law (the tax portion of which is technically known as the Tax Extenders and Alternative Minimum Tax Relief Act of 2008) extends the IRA Charitable Rollover that expired at the end of 2007. Between now and December 31, 2009, individuals age 70½ and older will be able to contribute up to $100,000 per year in calendar years 2008 and 2009 from their IRAs to charities tax-free. Eligible donors have the last three months of 2008 and all of 2009 to take advantage of this important giving opportunity.

As was the case in 2006 and 2007, the extension does not permit IRA Charitable Rollovers to fund life income gifts such as Charitable Gift Annuities and Charitable Remainder Trusts. However, as illustrated in the examples below, the IRS recently clarified that (1) an IRA Charitable Rollover may be used to honor previously outstanding pledges to charities and (2) IRA Charitable Rollovers may be made from inherited IRAs.

The benefit of making a direct distribution from an IRA to charity is that the IRA owner can exclude up to $100,000 of the distribution from his or her gross income, and such distributions are counted as part of their annual minimum required distributions. Because the IRA distribution is excluded from gross income, the IRA owner is not entitled to a charitable income tax deduction for the charitable gift. There are several requirements that must be met in order to ensure that the charitable IRA distribution will be excluded from gross income.

Technical Requirements

First, the IRA owner must be at least age 70½ on the day of the transfer from the IRA to the charity.

Second, the donation must be made directly from an IRA. Donations from other types of retirement plans such as 401(k) plans, profit sharing plans, pension plans or Section 403 (b) annuities will not qualify. However, amounts rolled over from such a "non-qualifying" plan to an IRA, and then distributed to a charity should qualify.

Third, the donation must be made directly from the IRA to the charity. This means that a donation to a charity will not qualify if a check is paid from the IRA to the IRA owner who then endorses the check to the charity.

Fourth, the recipient charity must be a public charity. Contributions to donor advised funds, charitable trusts and supporting organizations will not qualify.

Fifth, a distribution will only qualify if the donor would normally be able to claim a charitable income tax deduction for the entire payment. This means that IRA distributions that are used for certain types of donations such as auctions, raffle tickets, and fund-raising events will not qualify. For instance, suppose you make an IRA distribution to purchase a ticket for a fundraising dinner for a charity and a portion of the ticket price covers the cost of your dinner and the balance of the ticket price would normally qualify for a charitable income tax deduction. In that case, no part of your IRA distribution will qualify since you would normally be able to claim a charitable income tax deduction for only a portion of the ticket price.

Finally, the donation must be made from assets which would otherwise be considered a taxable distribution from the IRA. In general, distributions from IRAs are taxable. However, if an IRA owner made any nondeductible contributions to the IRA, then distributions from those amounts to the IRA owner are generally not taxable. Accordingly, only that portion of the IRA distribution that is considered taxable will qualify.

Examples of a Qualifying IRA Distribution

1. New Gift to Charity. John, age 73, is the owner of a $2 million IRA. John would like to make a $100,000 gift to charity. On December 1, 2008, John directs his IRA administrator to make a direct distribution of $100,000 from his IRA to the Juvenile Diabetes Foundation (a qualifying charity). The IRA administrator issues a check for $100,000 payable from the IRA to the Juvenile Diabetes Foundation and sends it to the charity. John would be allowed to exclude the $100,000 charitable IRA distribution from his gross income in 2008.
2. Outstanding Pledge Payment to Charity. Joan, age 74, is the owner of a $3 million IRA. On October 1, 2008, Joan pledged to make a gift of $100,000 to the American Cancer Society (a qualifying charity). On December 1, 2008, Joan directs her IRA administrator to make a direct distribution of $100,000 from her IRA to satisfy her outstanding pledge. The IRA administrator issues a check for $100,000 payable from the IRA to the American Cancer Society and sends it to the charity. Joan would be allowed to exclude the $100,000 charitable IRA distribution from her gross income in 2008.
3. Gift to Charity From An Inherited IRA. Ben Smith, age 73, is the owner of a $500,000 inherited IRA account that he inherited from his deceased uncle, Tim Smith. The name of the account is "Tim Smith, deceased, for the benefit of Ben Smith." Ben would like to make a $100,000 gift to charity. On December 1, 2008, Ben directs his IRA administrator to make a direct distribution of $100,000 from his inherited IRA to his favorite hospital (a qualifying charity). The IRA administrator issues a check for $100,000 payable from the IRA to the hospital and sends it to the charity. Ben would be allowed to exclude the $100,000 charitable IRA distribution from his gross income in 2008.

Who Benefits

IRA owners who are at least age 70½ and who do not itemize their deductions may benefit the most from the new provision. This is because a donor who makes a charitable gift from his or her IRA has to report the entire distribution as taxable income, but does not receive an offsetting income tax deduction since he or she does not itemize deductions. Taxpayers who do not itemize their deductions are often middle and lower income taxpayers or residents of states that do not have a state income tax (such as Florida).

Donors who lose tax deductions as their adjusted gross income ("AGI") increases may also benefit from the new provision. Itemized deductions are subject to a phase-out as the amount of the taxpayer's income increases over $159,950 ($79,975 if married filing separately) for 2008. By keeping AGI lower, a taxpayer can deduct more itemized deductions.

Donors who live in states that do not provide for income tax breaks for charitable gifts may also benefit from the new provision. For example, several states, including New Jersey and Massachusetts, do not permit itemized deductions. As a result, residents of those states get no state income tax breaks for making gifts to charity. Eligible donors in those states will save taxes at their highest marginal state income tax rate for every gift they make from their IRAs instead of from their checking accounts.

Donors who are subject to the 50% charitable deduction limitation may also benefit from the new provision. Generally, charitable deductions cannot exceed 50% of a taxpayer's AGI in any year. A donor who is subject to the 50% charitable deduction limitation and who makes a taxable distribution from an IRA to make an additional charitable gift would generally be able to deduct only 50% of the amount in the year of the gift (the excess is carried forward for up to five years). The other 50% of the IRA distribution would be subject to income tax that year. Under the new provision, if the charitable gift is made directly from the IRA, an eligible donor would not pay any additional income tax on that amount.

Conclusion

IRA owners who are at least age 70 1/2 in 2008 and 2009 should consider making a distribution from their IRA to a charity. Eligible donors who are most likely to benefit are those who do not itemize their deductions or who live in states that do not permit itemized deductions or who otherwise benefit by keeping their AGI lower.

No Contest Clauses and Recent California Changes Affecting Them

A no contest clause, also known as an in terrorem clause, generally provides that if a person contests any portion of a decedent's estate plan, that person forfeits anything that was left to him or her under the decedent's Will or revocable trust. A no contest clause is designed to discourage challenges to a decedent's estate plan. In essence, a no contest clause disinherits any person who challenges a decedent's testamentary documents or transfers made pursuant to such documents. In most states, the people who would inherit your property if you died without a Will, have the right to contest your estate plan. This normally includes children and if a child predeceases you, it can include more distant relatives.

Not all states recognize these no contests clauses as valid and enforceable. Some states where they are operative include California, Connecticut, New Jersey and New York. But in Florida these clauses are not valid and enforceable. If you live in a state where such clauses are recognized, you may wish to leave something to a relative that you wish to disinherit, coupled with a no contest clause, with the hope that doing so will dissuade that individual from challenging your estate plan. The bequest must be significant enough to deter that individual from risking it if the challenge is unsuccessful. If there is a large disparity between the size of the bequest and the share that the person stands to inherit if the contest is successful, then the no contest clause may not serve as a disincentive to litigation.

California Changes

Most California testamentary documents, particularly Wills and trusts, contain no contest clauses. Recent events in California Law have significantly impacted the validity and applicability of no contest clauses.

In the recent case of *Perrin v. Lee*, 79 Cal. Rptr. 3d 885 (2008), the California Court of Appeal was asked to determine the applicability of a no contest clause to an amendment to an instrument containing the clause. In *Perrin*, the Petitioner sought to challenge the validity of two amendments to a trust, where the original trust contained a no contest clause. Neither amendment included a no contest clause or made reference to the clause in the original trust, and the original trust did not state that the no contest clause was to apply to future amendments. The Court in *Perrin* held that the Petitioner's challenge to the amendments would not violate the no contest clause because the original no contest clause did not explicitly apply to the amendments.

Additionally, the California legislature recently enacted Senate Bill 1264, which materially alters the statutory body of law on no contest clauses. (S.B. 1264 2007-08, Reg. Sess. (Cal. 2008).) This legislation will be effective on January 1, 2010, and will apply to all documents that became or will become irrevocable on or after January 1, 2001.

One major change that will be implemented by Senate Bill 1264 is that no contest clauses will be enforced against only certain types of contests. "Direct contests" will only be deemed to violate the no contest clause if brought after 2010 without probable cause. "Direct contests" are the classic methods of attacking documents and include challenges based on the following: 1) forgery; 2) lack of due execution; 3) lack of capacity; 4) menace, duress, fraud, undue influence; 5) revocation of a testamentary document pursuant to the procedure provided by statute; and 6) disqualification of a beneficiary as an interested witness or prohibited transferee as provided by statute. Additionally, the Bill provides that a no contest clause may be enforceable against the following contests, but only if the no contest clause expressly provides for such application: 1) a challenge to transfer of property alleging that the decedent did not own the property and 2) the filing or prosecution of a creditor's claim against the estate of the decedent.

If you have a California trust or will that has been amended and you believe that deterring contests to your estate plan is important, we advise you to contact your estate planning attorney to incorporate the recent changes in the law into your estate plan. Additionally, if you are interested in deterring challenges to your estate plan via the filing of creditor's claims against your estate or challenges to whether or not you own certain property, please contact your estate planning attorney prior to 2010 to ensure that your estate plan properly accounts for the changes in the law.

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