

Estate Planning for Real Property

Representing Landowners in Wind Energy Projects
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Kelli A. Enders
Fredrikson & Byron, P.A.

Introduction and Background

Real property is “[l]and and anything growing on, attached to, or erected on it, excluding anything that may be severed without injury to land.” – Black’s Law Dictionary

Introduction and Background

Unique asset:

- Asset of most clients
- Costly and appreciating (usually)
- Emotional
- Immobile, unique, scarce

Real Property Considerations

Types of ownership:

- Fee simple (or freehold)
- Life estate or estate for years
- Leasehold
- Reversion (or remainder)
- Concurrent or co-tenancy:
 - Joint tenancy with rights of survivorship (JTWROS)
 - Tenants in common

Real Property Considerations

- Debt and mortgage
- Situs (location)
- Basis:
 - Adjusted basis
 - Carry-over basis for gift
 - Stepped-up basis for bequest, except in 2010, when modified carry-over basis
 - Realize gain on sale or exchange (unless exception)
- Value

Real Property Considerations

Categories:

- Personal use property
- Business use property:
 - Used as part of a trade or business
 - Rental (income producing)
 - Investment (may be income producing)
 - Farm

Common Estate Planning Goals

- Minimize taxes
- Minimize probate costs
- Transfer assets to family
- Asset Protection
- Diversification
- Charitable Planning

Common Estate Planning Goals

Objectives for lifetime transfers:

- Retain (some) control and/or use
- Relief from income tax
- Minimize gift tax implications
- Remove (property or appreciation) from estate*

Achieving competing objectives is challenging.

* *To the extent there are applicable state and/or Federal estate, death or inheritance taxes.*

Client Considerations

- Size of estate (or net worth)
- To the extent applicable, gift, estate and GST exemptions remaining
- Age and general health

Current State of Federal Transfer Taxes

	<u>2009</u>	<u>2010</u>	<u>2011</u>
Gift Tax Exemption	\$1M	\$1M	\$1M
Max. Gift Tax Rate	45%	35%	55%, with 5% surcharge on gifts between \$10M and \$17.184M
Estate Tax Exemption	\$3.5M	Unlimited	\$1M
Max. Estate Tax Rate	45%	None	55%, with 5% surcharge on gifts between \$10M and \$17.184M
GST Tax Exemption	\$3.5M	Unlimited	\$1M indexed for inflation since 1999
GST Tax Rate	45%	None	55%
Basis of Bequest	Stepped-Up	Carryover + Special Basis Adjustment and Spousal Basis Adjustment	Stepped-Up

Current State of Federal Estate Tax

Possible Congressional action to eliminate uncertainty and disparity in transfer tax laws:

- Enact legislation, *effective retroactively to January 1, 2010*, and either extend 2009 tax laws or enact new laws.
- Enact legislation, *effective as of the date of enactment*, and either extend 2009 tax laws or enact new laws.
- Do nothing.

Disposition Techniques

The following is a discussion of selected disposition techniques, the advantages, disadvantages and consequences of each.

A majority of these techniques are motivated in part by a desire to reduce the size of the client's estate in an effort to minimize applicable estate taxes and as such the consequences are dependent on the estate tax laws in effect at the time of disposition and actual transfer to the beneficiary.

Disposition Techniques

- Do nothing - Hold property until death. Property will pass by operation of law to heirs (pursuant to will, trust or statute).
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques – Outright Transfers with no Consideration

- Transfer entire interest - Transfer entire interest pursuant to quit claim or warranty deed.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques – Outright Transfers with no Consideration

- Transfer on Death Deed (TODD) - Transfer interest effective on death pursuant to a TODD
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques – Retained Use or Income

- Transfer partial (undivided interest) -
Transfer partial undivided interest(s)
pursuant to quit claim or warranty deed.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques – Retained Use or Income

- Retain life estate - Transfer interest in property but retain life estate pursuant to quit claim or warranty deed.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques – Retained Use or Income

- Gift-lease back - Transfer entire interest in property and enter into lease agreement with transferee to lease use of property.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques-Outright Transfers with Consideration

- Sale for full and adequate consideration
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques-Outright Transfers with Consideration

- Bargain Sale - Transfer that is part gift, part sale; occurs with transferor sells property to another for less than fair market value.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques-Outright Transfers with Consideration

- Installment sale - Sell property to another where at least one payment is received by seller after the tax year in which the sale occurs; often pursuant to a note.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques-Outright Transfers with Consideration

- Self-cancelling installment note (SCIN)-Sell property to another in exchange for an installment note that contains a provision cancelling the note upon occurrence of a cancellation event, typically the seller's death.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques-Outright Transfers with Consideration

- Private annuity-Sell property to another in exchange for an annuity, typically ending upon the transferor's death.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques-Outright Transfers with Consideration

- 1031 exchange (also known as a like kind exchange)-If an asset is sold and the proceeds from the sale are reinvested in a like kind asset, no gain or loss is recognized.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques – Transfers in Trust (Caution: See IRC Sec. 2511(c))

- Generally:
 - Transfer assets into a trust, the terms of which give the transferor/grantor an interest in the assets for a period of time.
 - At the end of the term, assets are distributed to beneficiaries.
 - If the retained interest is a “qualifying interest,” the amount of the gift will be the value of the remainder interest. (Contrast with a life estate, where the amount of the gift will be the entire value of the property.) See IRC Sec. 2702.

Disposition Techniques – Transfers in Trust (Caution: See IRC Sec. 2511(c))

- Balance competing goals:
 - Retain enough interest or control over the property so transferor treated as owner for income tax purposes.
 - Give beneficiaries enough access to assets so will qualify as a present interest.
 - Not retain too much interest or control to cause transfer to not be a completed gift.
 - Not retain too much or control to cause assets to be included in estate.

Disposition Techniques – Transfers in Trust (Caution: See IRC Sec. 2511(c))

- Qualified personal residence trust (QPRT)- Transfer personal residence to a trust that qualifies as a QPRT. During trust term, transferor/grantor may use the residence. Upon cessation of trust term, residence distributed to beneficiaries; transferor/grantor may rent for fair value thereafter.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques – Transfers in Trust (Caution: See IRC Sec. 2511(c))

- Grantor retained annuity trust (GRAT)-Transfer property to a trust that qualifies as a GRAT. During trust term, grantor receives annuity calculated based on the IRC Sec. 7520 rate then in effect. Upon cessation of trust term, the remaining assets are distributed to beneficiaries.
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Disposition Techniques – LPs and LLCs

- (Family) limited partnership (FLP or LP) or family limited liability company (FLLC or LLC)
 - Client forms entity and contributes assets in exchange for ownership interests.
 - Exchange constitutes a sale or exchange of which there are no income tax consequences.
 - Client may then transfer ownership interests to family members via gift or sale transaction.

Disposition Techniques – LPs and LLCs

- (Family) limited partnership (FLP or LP) or family limited liability company (FLLC or LLC)
 - Advantages and disadvantages
 - Tax and non-tax consequences
 - When is this technique appropriate?

Questions

Kelli A. Enders, Esq.
Fredrikson & Byron, PA
200 South Sixth Street, Suite 4000
Minneapolis, MN 55402-1425
(612) 492.7343
kenders@fredlaw.com

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