

# Enduring Wealth



THE LAW OFFICES OF JOHN C. MARTIN

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## Estate Planning for Pets and Domesticated Animals



Companionship animals play an important role in the lives of humans. Cats keep us company on the couch. Dogs play Frisbee with us at the park. Pets can even prolong a person's life, lowering the risk of heart attack and depression. Despite these beneficial effects in the lives of humans, more than 500,000 pets are euthanized in animal shelters throughout the United States annually because of the death or disability of the owner. How can pet owners prevent such a disaster from occurring? In this article, Attorney Martin explores three ways to provide

for financial support and care for your pet when you no longer can.

### 1st Solution: Give your Pet to a Friend or Relative

Under California Probate Code, Section 6102, an outright gift to an animal is void. However, you can give your pet to a close friend or relative, along with funds to provide for their care. An attorney can help you draft language in your will or trust so that the gift will be valid.

There are many downsides to giving your pet to a friend or relative. First, the friend or relative may not want to take care of your pet. Even if they express a desire today, your friend or relative may move away or face new life circumstances, making them unable or unwilling to provide proper care and support for your pet.

Second, once your friend takes legal ownership of your pet, there is no guarantee that they will fulfill your desires, whether expressed orally or in a will. A worst-case scenario is an immediate euthanization of the pet upon a change of ownership, regardless of your best intentions.

### 2nd Solution: Give your Pet to an Animal Protection Organization

The second solution is to give your pet to an animal protection organization. Many organizations exist throughout California, which provide either permanent care or adoption services. A lawyer can help you add language to your will or trust to legally give your pet to an organization like the San Francisco SPCA or Pets in Need of Redwood City. Many of these organizations may also enable you to specify the type of home that would be suitable for your pet.

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## 3 Ways to Save your Heirs Thousands in Property Taxes

In California, one's property tax basis can increase only 2% per year unless a change in ownership is recognized. This bodes well for children of property owners: parents can pass on a house to their children without recognizing any change in ownership. The effects can be significant. For instance, say Bill Parent bought his California house in 1979 for \$300,000. Annual property taxes are fixed at 1% of the assessed

value, which can increase only by 2% per year. Thus, property taxes, which were \$3,000 per year in 1979, would only be \$5,434 per year in 2009, assuming the maximum 2% increase in basis were imposed. Today, the house is worth \$1.2 million. If a change in ownership were recognized, the new owners would start with \$12,000 in annual property taxes! However, if Bill Parent sells the house to his child, or leaves the house to his child

under a will or trust, no change in ownership would be recognized, and the child would save thousands annually by inheriting his parent's property tax basis. Well meaning parents often lose the exception from reassessment inadvertently. In this article, we explore three ways that the exception from reassessment can be lost, and what to do about it. ....

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# Enduring Wealth

## Estate Planning for our Furry Friends



“THE PROBATE CODE’S REQUIREMENT THAT PRINCIPAL AND INCOME BE PAID OUT ONLY FOR THE PET’S BENEFIT PROVIDES ADDED CERTAINTY THAT MONEY WILL GO ONLY FOR THE PET..”

*Continued from page 1* ...Others require a planned gift to be made along with your pet. Organizations include the SPCA, the Humane Society, the National Cat Protection Society, Pet Pride, Pets in Need, UC Davis School of Veterinary Medicine, and the California Feline Foundation.

A gift to an organization like the SPCA is an excellent solution for many pet owners. Yet, for many, such a gift may not be sufficiently personal. Moreover, it cannot be guaranteed exactly how money for long term financial support will be provided and whether proper placement of the pet can be achieved.

### 3rd Solution: Pet Trusts

The third solution is to provide for your pet under a pet trust. Under Section 15212 of the California Probate Code, trusts for pets are allowed for an animal’s lifetime. A pet trust is the best way to provide for

one’s pets, offering greater certainty and provision than an outright gift to a friend or charitable organization.

First, you can provide specific instructions on how your pet should be cared for. The trust may nominate potential caretakers, giving the trustee discretion to provide a suitable guardian and home. The trust can delineate how medical expenses, pet care, pet visits, and other duties are handled.

Second, the Probate Code’s requirement that principal and income be paid out only for the pet’s benefit provides added certainty that money will be properly directed.

Third, the pet trust is more easily enforced than an outright gift. A regular accounting of expenses can be required, whereby a person designated in the trust, or a beneficiary, ensures that principal and income are paid for a pet’s

benefit.

Finally, a pet trust prevents your pet from falling through the cracks. Under the Probate Code, any nonprofit charitable organization that cares for animals, or a beneficiary or person designated by the trust, may make reasonable inspections to ensure that the books and records of the trust, the pet’s health, and the pet’s living arrangements are proper.

Pet trusts are not for everyone. Unfortunately, a pet trust that leaves a remainder to charity is not eligible for an estate tax charitable deduction. Moreover, the expenses associated with administering a pet trust may rule out their use unless they are funded with a relatively large amount of money. Finally, while enforcement mechanisms under a pet trust are better than the alternatives, there is still no guarantee that the trustee will act completely in the pet’s interest.

## 3 Ways to Save your Heirs Thousands in Property Taxes

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### 1st Mistake: The Buyout

Bill Parent decides to write his will, which gives his assets to his two children, Timmy and Tammy, equally. At his death (Bill Parent was a widower), neither Tammy’s nor Timmy’s 50% share of the house will be reassessed. However, Timmy wants to “buy out” Tammy from her share of the house. While Bill Parent wanted everything to be equal, what two siblings can share a house? Unfortunately, because no sibling to sibling exception from re-assessment exists, the 50% share passing to Timmy will be re-assessed at its current value. This would leave Timmy with a \$11,434 bill for property taxes rather than a \$5,434 bill.

There are a number of ways Bill Parent can prevent making this mistake. First, he can give the house to the child who needs it most. The problem with that approach is the final distribution of assets might not be equal. He also may not know who would need the house most at the time of his death. Second, he can create a revocable living trust, giving the trustee discretion to make non pro rata allocations of all property in the trust. This allows the trustee to give the house to one child and the remaining assets to another as long as the end values are equal. The problem with this approach is that there may not be enough assets in the trust to equalize the distribution. Accordingly, the trustee may be

given the discretion to mortgage the house. The house passes to Timmy, preserving the full exemption. The proceeds of the loan pass to Tammy, equalizing the transaction. At the end of the day, Timmy preserves the low property tax basis enjoyed by Bill Parent, and Tammy inherits assets of equal value.

### 2nd Mistake: To my close friend, for her life

Bill Parent’s wife passed away years ago. His close friend Renée has been his trusted companion during the last years of his life, and Bill is Renée’s main financial support. Renée is advanced in years, and Bill doesn’t know who will pass away first. ...*Continued on the next Page.*



If structured property, parents can pass on a house to their children without any reassessment of property tax.



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### 3 Ways to Save your Heirs Thousands in Property Taxes

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Bill wants to make sure that upon his death, Renée will be well provided for if she is still living. He writes his will, giving Renée the right to live in the house until her death, after which time the house will pass to Timmy and Tammy. Bill Parent doesn't know too much about Property Law, but he heard from Tammy, a law student, that a life estate is not equal to a "fee simple absolute."

Therefore, Bill Parent figures that the house won't be reassessed since Renée will never actually "own" the house outright.

When Bill Parent passes away, Renée is still living. The house will be reassessed, because Renée will be deemed to have received a "present interest" in the property, and no exception exists for transfers to close friends. While Renée doesn't own the house in "fee simple absolute," she does have a right to immediate possession. Under California law, that suffices as a change in ownership and the new property tax basis will be \$1.2 million. When Renée passes away, the children will face the full property tax bill.

Unfortunately, it will be difficult to give Renée any

rights regarding the house without losing the exception from reassessment. Bill can provide for Renée, however, by setting aside assets other than the house in his trust, and giving the trustee discretion to pay income to Renée for her life, with the principal passing to the children upon her death. This alternative achieves Bill's goal of financial support without sacrificing the parent-child exception from reassessment.

#### 3<sup>rd</sup> Mistake: Transfers to Grandchildren

Tammy has graduated from law school, pursued a successful career, and now has a child of her own, Tasha. Bill Parent would like Tasha to have the house, since both of his children now have homes and Tasha needs it the most. However, Bill Parent realizes that he would lose the parent-child exception from reassessment. Accordingly, he writes his trust, providing that Tammy will have a right to purchase the house, after which she will be required to sell the house immediately to Tasha. Bill Parent pats himself on the back: this way, he figures, he will take advantage of two parent-child exceptions. He believes that both transfers will preserve the low property tax basis.

Unbeknownst to him, a rule

called the "step transaction doctrine" will treat a set of transactions as a single transaction if the purpose was to avoid taxation. Because Bill Parent's trust explicitly requires Tammy to transfer the house to Tasha, the intent to avoid reassessment appears clear. Bill Parent should therefore not require that Tammy sell the house to Tasha. Unfortunately, there is no clear law as to how much time must pass before Tammy can then sell the house to Tasha while preserving her own parent-child exception. Bill Parent, and later his trustee, should consult with a lawyer to make sure that a sale does not unknowingly trigger the step transaction doctrine.

#### Conclusion

Proposition 13 has enabled property owners to transfer real estate to their children with a low property tax basis. However, several common mistakes thwart the parent-child exception. It's always a good idea to consult with a lawyer when preparing a will or trust, or handling a decedent's estate. A little bit of good advice can save your heirs thousands in property taxes.

"THE "STEP TRANSACTION DOCTRINE" WILL TREAT A SET OF TRANSACTIONS AS A SINGLE TRANSACTION IF THE PURPOSE WAS TO AVOID TAXATION."



Structuring a transfer of property correctly can save your heirs thousands in property taxes.

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