High Net Worth Family Tax Newsletter
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Welcome to Loeb & Loeb's High Net Worth Family Tax Report. We hope you like our new look and new layout, designed to make it easier to find the articles you're looking for.

As we have for more than 15 years, in each issue we bring you in-depth articles highlighting important topics and providing practical insights for high net worth individuals, with a focus on trusts and estates, tax, family offices and tax-exempt organizations.

In this issue, senior counsel Christina Hammervold details the beneficial ownership information that many U.S. privately held corporations, limited liability companies and other entities will soon be required to report to the U.S. Department of the Treasury Financial Crimes Enforcement Network (FinCEN) under proposed regulations.

In our article on charitable and marital deduction planning for bequests of fractional property interests, we explore a recent tax case that highlights potential pitfalls in this complex area. And in "Dividing a Family Foundation: A Potential Solution for Boards Facing Intra-Family Conflict," associate Brittney Butts discusses the options for family foundations when the collaborative pursuit of philanthropic goals is challenged by divorce and other family conflicts.

As the 2022 elections get underway, associate Nick Warshaw has prepared a guide to help readers navigate the donation limits and reporting requirements of the different and sometimes overlapping federal, state and local campaign finance laws. Partner Ryan Austin explains the significant changes to California property tax law affecting transfers of residences and other property from parents to children after the passage of Proposition 19. And finally, senior counsel Jennifer Smith has some important reminders about the 2022 adjustments in transfer tax exemptions and interest rates.

Attorney Advertising

New Beneficial Ownership Reporting Requirements for Privately Held LLCs and Other Entities

Many privately held limited liability companies (LLCs), corporations and other entities formed or registered to do business within the U.S. will soon be required by federal regulations to file reports to disclose their beneficial ownership and to update those reports to reflect changes to their beneficial ownership on an ongoing basis.

Key Takeaways

- The requirements will apply to privately held corporations, LLCs and other entities formed or registered to do business in any U.S. state (or with any American Indian tribe) for any purpose (including for estate, investment, real estate, tax, privacy or other personal planning).
- The new reporting requirements will not take effect until the issuance of final regulations (which are expected soon) and will apply to all qualifying entities, including those created before the effective date.
- Although most trusts used for estate planning would not be considered reporting companies under these requirements, information about a trust's beneficial owners (grantors/settlors, beneficiaries, trustees, etc.) may be reportable if the trust directly or indirectly owns an interest in a reporting company.
- The beneficial ownership information reported to the U.S. Department of the Treasury Financial Crimes Enforcement Network (FinCEN) will not be part of any publicly accessible database.

Overview

These new reporting requirements are the result of the passage of legislation, the Corporate Transparency Act (CTA), enacted on Jan. 1, 2021, designed to combat the use of entities for illicit activities. The CTA directed the U.S. Department of the Treasury to issue regulations to implement the reporting requirements contained in the CTA. FinCEN released the first proposed regulations in December 2021.

As of now, no reporting is required, and no effective date has been announced. We anticipate, however, that the effective date will be set by the final version of these regulations and that certain reporting requirements may be retroactive.

This article covers key components of the new reporting regime, including:

- Which entities must file
- Who must be identified in the reports
- What information must be provided
- When to file reports
- Whether the information will be public
- Who will have access to the information
- The penalties for noncompliance

Please note that the rules summarized in this article are largely based on the proposed regulations, which are not final and are subject to change.

Which entities must file beneficial ownership reports?

Reporting Companies. The CTA imposes filing obligations on "reporting companies," which include both:

- Domestic reporting companies, including corporations, LLCs and other entities created by the filing of a document with a secretary of state or any similar office under the law of a state or American Indian tribe
- Foreign reporting companies, including non-U.S. entities that are registered to do business in any state or tribal jurisdiction

Importantly, only an entity that is created or is registered to do business by the filing of a document with a U.S. state or American Indian tribe falls within the definition of reporting company. As a result, while business trusts (such as statutory trusts or Massachusetts business trusts) likely will fall within the definition, most trusts used for estate planning purposes should not, since such trusts are generally not created (or registered to do business) by the filing of a document with a government authority. Information about any trust's beneficial owners (e.g., settlors, beneficiaries, trustees) may nonetheless end up being reported to FinCEN if the trust directly or indirectly owns an interest in a reporting company.

Exempt Entities. The CTA exempts certain entities from reporting, including highly regulated entities and other entities that have been identified as posing a low risk for money laundering and other financial crimes (e.g., large operating companies with a physical presence in the U.S.).

Who must be identified in the reports?

The CTA requires two categories of individuals to be identified in beneficial ownership reports: (1) beneficial owners and (2) applicants.

Beneficial Owner. The term "beneficial owner" means any individual who, directly or indirectly, does one of the following:

- Exercises substantial control over the reporting company
- Owns or controls not less than 25% of the ownership interests of the reporting company

"Substantial control" is defined in the proposed regulations to include (1) service as a senior officer, (2) authority to appoint or remove any senior officer or a majority (or dominant minority) of the board (or similar body), (3) decision-making authority or substantial influence over important company matters, and (4) any other form of substantial control. Each individual who has the right to exercise substantial control must be identified and reported.

With respect to the disclosure of individuals who own or control at least 25% of the ownership interests, the proposed regulations define ownership interests broadly to include equity as well as other types of interests (such as capital or profit interests, convertible instruments, futures, warrants, options, etc.).

If an ownership interest in a reporting company is held through a trust, all the individuals listed below are each deemed to have an ownership interest in that reporting company:

- A grantor/settlor who has the right to revoke the trust or otherwise withdraw the trust's assets
- A beneficiary who is the sole permissible recipient of the trust's income and principal
- A beneficiary who has the right to demand a distribution of or withdraw substantially all of the trust's assets
- A trustee of the trust
- Any other individual who has the authority to dispose of trust assets

Certain categories of individuals are excluded from the definition of beneficial owner, including minors (provided that information for a parent/guardian is provided), nominees, intermediaries, custodians, agents acting on behalf of others, individuals acting solely as employees (and not as senior officers), individuals whose only interest is through a right of inheritance, and creditors. Information regarding these individuals would still need to be disclosed if they qualify as "applicants," however.

Applicant. The term "applicant" means any individual who files an application to form an entity or registers an entity to do business in the U.S., even if the person is acting only as an agent (such as a law firm employee) to assist in creation of the entity. As clarified by the proposed regulations, an applicant also includes "any individual who directs or controls the filing of [the] document by another person."

What information must be reported?

A reporting entity must provide the following for each beneficial owner and each applicant:

- Full legal name
- Date of birth
- Current address
- Identification number from an acceptable identification document (such as an unexpired passport or driver's license)
- An image of the identification document showing both the individual's photograph and the identification number

Alternatively, individuals can request and use a FinCEN identifier number (FIN), which can be obtained by providing FinCEN with the above information. The required information must be updated whenever there is a change. A FIN could simplify this process, particularly where the same beneficial owner or applicant has been reported for multiple entities. Updates to the FIN information should apply to every report in which the FIN was used so that each separate entity report does not need to be tracked and updated.

A reporting company also must provide information about itself, including the full name of the company, any trade or doing business name, the business street address, the jurisdiction of formation or registration, and the IRS taxpayer identification number (TIN). If a company does not have a TIN, it should provide a Dun & Bradstreet Data Universal Numbering System Number or a Legal Entity Identifier.

When must reports be filed?

No reporting is required yet, but it will likely be required soon. The timing is unclear, as the effective date will be set by final regulations, which have yet to be issued.

New and existing entities have different filing deadlines:

- Existing entities must file initial reports within one year of the effective date of the final regulations.
- New entities (i.e., entities formed/registered after the effective date) must file an initial report within 14 days of the date they are formed or registered.

Reporting companies are also required to update information in a timely manner and correct any inaccurate information. The proposed regulations give reporting companies 30 days to file updates (e.g., to report changes in beneficial ownership and any change with respect to the information reported for a beneficial owner or applicant, such as an address change) and 14 days to correct inaccurate reports.

Will the information be public?

No, the database will not be available to the public.

Who will have access to the information?

All information reported in accordance with these rules will be stored in a secure private database maintained by FinCEN. The information will be available only in limited situations upon appropriate request by U.S. federal law enforcement agencies (including requests made by U.S. federal authorities on behalf of non-U.S. law enforcement), state and local law enforcement with court authorization for such information, financial institutions that have the consent of the business entity in question, and certain federal regulatory agencies. The Treasury Department has its own broad authorization to use the information, including for tax-related purposes.

The CTA imposes penalties for the unauthorized disclosure or use of the information.

What are the penalties for noncompliance?

Civil and criminal penalties may apply to filing failures. For example, any person who willfully fails to report complete or updated beneficial ownership information to FinCEN faces fines of up to $10,000 and/or imprisonment for up to two years. The same penalties also apply to any person who willfully provides (or attempts to provide) false or fraudulent beneficial ownership information. Penalties may apply to reporting companies as well as to responsible individuals and other entities. Penalties may apply to individuals who direct a reporting company not to report or are in substantial control of a reporting company when it fails to report complete or updated beneficial ownership information.

Any noncomplying entity will also likely find it difficult to open or maintain a bank account, particularly in the U.S.

Pitfalls in Charitable and Marital Deduction Planning for Bequests of Fractional Property Interests

Planning in the context of the estate tax charitable or marital deduction is a complex area, particularly when making bequests of fractional interests in a single asset intended to qualify for one of these deductions.

A recent case in this area highlights potential pitfalls that can result in the reduction of these estate tax deductions and consequently in unforeseen estate taxes.

Charitable Deduction Planning: *Estate of Warne v. Commissioner*

The recent case of *Estate of Warne v. Commissioner* illustrates how making testamentary bequests of interests in a single illiquid asset among multiple charities can cause a mismatch between the value of the asset included in the gross estate of the decedent and the amount allowable as a charitable estate tax deduction.

In *Warne*, the decedent's revocable family trust owned 100% of a limited liability company (LLC) with a fair market value of $25,600,000 on her date of death. The terms of the revocable family trust provided for the donation of 75% of the LLC to one charity and 25% to another charity, for which the decedent's estate claimed a combined charitable deduction of $25,600,000 (the LLC's value in her estate). The Tax Court held that, even though the value of the estate must include 100% of the value of the LLC, it may only deduct the value of the assets that were actually received by the charities (the separate 75% and 25% interests), which were subject to valuation discounts for lack of marketability and control. The combined discounted value of the separate charitable interests was over $2.5 million less than the LLC's total value included in the estate.

Because of the mismatch between the value included in the decedent's gross estate and the value of the estate tax charitable deduction, the estate owed an estate tax with respect to an asset that passed entirely to charities.

With careful estate planning, the decedent could have avoided this unfortunate result. For example, the decedent could have given the entire LLC to a private foundation, which then could have transferred some or all of the LLC interests to other charities. The estate tax charitable deduction for the bequest of the LLC to a single charity would have matched the value of the LLC as included in the decedent's estate.

Marital Deduction Planning: *Estate of Disanto v. Commissioner*

A similar potential mismatch can arise in the case of marital deduction planning, as was the case in *Estate of Disanto v. Commissioner*, where a surviving spouse disclaimed assets from the deceased spouse's estate, such that only a minority interest in a closely held entity (which was subject to a valuation discount) remained eligible for the marital estate tax deduction.

Plan With Care

These cases demonstrate potential hazards in constructing bequests of fractional interests in non-marketable property to achieve an estate tax charitable or marital deduction. Care must be taken to engage experienced counsel and appraisers to avoid inadvertently reducing or eliminating the intended deduction.

Dividing A Family Foundation – A Potential Solution for Boards Facing Intra-Family Conflict

Private foundations can be excellent philanthropic vehicles for spouses and family members to collectively pursue their charitable objectives. Serving as members of the foundation's board provides a unique opportunity for spouses to lead an organization together, for parents to teach their children about charitable giving and for family members to work together to carry on the family's philanthropic traditions. However, when spouses split or other family conflicts arise, the collaborative pursuit of charitable objectives may no longer be desired or feasible. In these cases, the parties may consider, among other options, dividing the foundation and distributing its assets to one or more newly created private foundations so the parties may pursue their charitable goals independently.

Tax-Free Division of a Private Foundation's Assets

Distributions from private foundations, including to divide the foundation, must comply with numerous rules under the federal tax code to avoid potential excise tax penalties. As most foundation managers are aware, a foundation's distributions to public charities are considered qualifying distributions. On the other hand, distributions to other private foundations are taxable, unless the distributing foundation exercises "expenditure responsibility"—i.e., enhanced pre-grant due diligence, continued oversight and reporting to the IRS to ensure that the grant is spent only for its intended charitable purpose. Expenditure responsibility is relatively easy to satisfy when making a grant to a private foundation for a specific project, but it would be burdensome when the distributing and receiving foundations want to go their separate ways. Distributions that effectively terminate a private foundation also can trigger a termination tax under Internal Revenue Code Section 507, which applies upon termination or forfeiture of private foundation status.

So how are foundation founders or board members with significant or irreconcilable differences to proceed? Fortunately, Code Sec. 507 provides an avenue that eliminates the expenditure responsibility requirements and avoids a potential termination tax upon the division of a private foundation. In instances when a foundation makes a "significant distribution" of its assets pursuant to any liquidation, merger, redemption, recapitalization, organization, reorganization or other adjustment (such as division of the foundation), the expenditure responsibility requirements and Code Sec. 507 termination tax will not apply. To constitute a significant distribution and qualify for the exception, the private foundation must distribute 25% or more of its assets to one or more other private foundations.

Dividing to Resolve Family Conflict

Divorcing spouses may use the Code Sec. 507 framework to divide the assets of their existing foundation without incurring tax on the transaction. The most straightforward and practical approach is for the transferor foundation to remain active and to distribute half its assets to a transferee foundation newly established by one of the spouses, which will constitute a significant distribution pursuant to a liquidation, reorganization, etc., under Code Sec. 507. In some instances, however, the soon-to-be ex-spouses may both prefer a "fresh start" for their charitable goals. In this case, the divorcing parties would (1) each establish their own new separate private foundation, (2) equally distribute all the assets of the existing foundation between the new foundations and (3) dissolve the original foundation. Either scenario results in two foundations holding an equal share of the assets and liabilities of the initial transferor foundation without the imposition of expenditure responsibility or a termination tax. For divorcing parties, this division results in a fair and equitable distribution of the original foundation and enables each of the parties to continue carrying out their own individual charitable objectives post-divorce.

Apart from divorce, family foundations may experience internal conflicts as the charitable objectives of multiple siblings or other family board members diverge over time. A division under Code Sec. 507 may also be an appropriate solution in these cases, as the existing foundation can make a significant distribution of assets to multiple foundations without incurring a termination tax, enabling family board members to pursue their separate charitable interests independently.

Alternatively, distributions made when dividing a private foundation may be directed to one or more donor advised funds selected by the parties. However, parties considering this route must be aware of the frequently changing laws governing donor advised funds. In fact, Congress is currently considering legislation (HR 6595 and its companion bill, S 1981, the Accelerating Charitable Efforts Act) that would, under certain circumstances, exclude distributions to donor advised funds as a type of qualifying distribution.

Costs Associated With Division

Although federal law provides a potentially tax-free path forward for dividing a foundation, costs may be incurred pre- and post-division to establish the new transferee foundation(s) and to potentially dissolve the transferor foundation.

- Establishing a Transferee Foundation. The costs associated with establishing a new foundation will include startup costs, staffing needs, state registration fees and legal, accounting and filing fees (IRS and state agencies).
- Dissolving the Transferor Foundation. If the division results in complete distribution of the assets of the original foundation, the fees for its dissolution will depend upon the law of the state(s) in which the foundation is incorporated and operated. In addition, the transferor foundation may incur costs associated with winding down its operations.

Consultation Prior to Division

In the event of divorce or conflicting charitable interests among family board members, dividing the assets of a private foundation may, in certain circumstances, be a wise solution. Those considering this path should consult qualified legal counsel before doing so to understand the potential costs and ensure compliance with the tax laws and other requirements associated with the division.

2022 Political Contributions: Highlights of Important Limits and Campaign Finance Rules

With the 2022 elections underway, we wanted to highlight some important campaign finance rules. If you plan to contribute to candidates, ballot measure committees, political parties or political committees (PACs) this election cycle, you must comply with campaign finance laws.

Federal Law

Under federal law, you may contribute up to $2,900 per election to any candidate running for United States Congress, the Senate or president. Federal law treats the primary and general elections as separate elections. Therefore, you may contribute up to $5,800 to a federal candidate.

You may contribute up to $36,500 per year to each national party committee's regular account (e.g., Democratic Congressional Campaign Committee (DCCC), Democratic National Committee (DNC), National Republican Congressional Committee (NRCC), Republican National Committee (RNC)). You may contribute unlimited amounts to independent-expenditure-only committees, known as super PACs. (Click here for additional information on federal contribution limits.)

Many business entities, including corporations and LLCs taxed as corporations, may not contribute directly to federal candidates. Corporations may contribute to super PACs.

California Law

Under California law, you may contribute up to $32,400 per election to gubernatorial candidates; up to $8,100 per election to any candidate running for statewide office besides governor (e.g., controller, attorney general); and up to $4,900 per election to assembly or state Senate candidates. California also treats the primary and general elections as separate elections. You may contribute unlimited amounts to most political committees engaging in independent expenditures. (Click here for additional information on California contribution limits.)

Corporations may contribute directly to California state candidates. Some local jurisdictions, like San Francisco, prohibit certain business entities from contributing directly to candidates for local office (e.g., supervisor, mayor).

Many counties, cities or special districts impose their own contribution limits (click applicable link for additional information on local contribution limits: Los Angeles, San Diego, Long Beach, San Jose and San Francisco). In cities and counties that have not passed their own campaign finance ordinance, California law imposes a default contribution limit of $4,900 per election to candidates seeking city or county office (e.g., county supervisor or councilmember). This default limit does not apply to special districts, such as school districts or water boards.

California imposes individual filing obligations on large contributors to California campaigns. An individual (or entity) contributing $10,000 or more in a calendar year (in the aggregate) to California state or local candidates or ballot measures is considered a major donor. Contributions to United States Congress or Senate candidates do not count toward this threshold. All major donors must file up to two campaign finance reports per year with the California Secretary of State. (Click here for the 2022 major donor filing schedule.) Failing to file a major donor report may result in administrative enforcement and fines by the California Fair Political Practices Commission or the Secretary of State. The media also periodically reports on these violations.

New York Law

New York imposes several limits on contributions depending on the type of election and the elected position.

Statewide Office. Under New York State law, individuals may contribute to state candidates seeking a party's nomination in a primary based on the total number of voters in that party. In 2022, an individual may contribute up to $22,600 to candidates seeking the Democratic Party's nomination for statewide office (governor, lieutenant governor, comptroller and attorney general) and up to $13,724 to candidates seeking the Republican Party's nomination for statewide office. Individuals may contribute up to $47,100 to candidates for statewide office in the general election regardless of their political party

State Senate. Individuals may contribute up to $7,500 in the primary election to candidates for the state Senate and up to $11,800 in the general election to candidates for the state Senate, regardless of their political party.

State Assembly. Individuals may contribute up to $4,700 in the primary election to candidates for state assembly and up to $4,700 in the general election to candidates for state assembly, regardless of their political party.

Immediate family members of candidates are subject to different contribution limits from those above (click here for additional information on family member contribution limits). When New York State begins its public financing regime on Nov. 9, 2022, all limits will be reduced (click here for additional information on the upcoming reduction in contribution limits).

A corporation or LLC may contribute up to $5,000 in total to New York political committees (including candidates) in a calendar year. Business entities and individuals may contribute unlimited amounts to independent expenditure committees or ballot proposition committees.

For the 2023 New York City Council elections, individuals may contribute up to $1,600 per election cycle (four-year period) to candidates who reject public financing and up to $1,050 per election cycle (four-year period) to candidates who accept public financing (click here for additional information on New York City Council contribution limits). All New York City candidates are prohibited from accepting contributions from corporations, LLCs and partnerships.

New York does not impose independent filing obligations on individual donors who simply contribute to candidates or other political committees. However, if you work with others to promote a political party or the success or defeat of a candidate or ballot measure, you should contact counsel to ensure you do not need to register your group as a political committee.

Illinois Law

Under Illinois law, individuals may contribute up to $6,000 per candidate per election cycle to any statewide, legislative or municipal (including Chicago) candidate. Illinois treats the primary and general elections as separate election cycles. Therefore, individuals may contribute up to $12,000 to a candidate running in both the primary and general elections. These contribution limits may be lifted if the candidate self-finances above certain thresholds or if independent expenditure spending exceeds certain thresholds (click here to see additional information on the various thresholds). Individuals may contribute unlimited amounts to independent expenditure committees or ballot initiative committees.

Corporations may contribute up to $12,000 per candidate per election cycle. (Click here for additional information on Illinois contribution limits.)

Illinois does not impose independent filing obligations on individual donors who simply contribute to candidates or other political committees. However, if you receive contributions to donate to political committees or spend funds advocating for the support or defeat of a candidate or ballot measure, you should contact counsel to ensure you do not need to register as a political committee.

Washington, D.C.

Under Washington, D.C., law, individuals may contribute up to $2,000 per election to candidates for mayor; up to $1,500 per election to candidates for attorney general and council chairman; up to $1,000 per election to candidates for at-large councilmember; and up to $500 per election to candidates for ward councilmember. D.C. treats the primary and general elections as one election for contribution limit purposes. This means individuals may give up to $2,000 total to a mayoral candidate. All contribution limits are significantly lower if the recipient candidate accepts public financing. Corporations may contribute to candidates other than candidates participating in D.C.'s public financing program. (Click here for additional information on D.C. contribution limits (see pages 19–20 and 45–46 for limits affected by public financing)).

D.C. does not impose independent filing obligations on individual donors who simply contribute to candidates or other political committees. However, under some circumstances, donors may need to sign a digital receipt and attach an affidavit to their contribution, affirming that the contribution is being made with the donor's own funds. If you receive contributions to donate to political committees or spend funds advocating for the support or defeat of a candidate or ballot measure, you should contact counsel to ensure you do not need to register as a political committee.

Other Jurisdictions

Most states and large cities have their own unique campaign finance laws. Some states may impose additional filing obligations on the contributor.

Rules Applicable Under Federal, State and D.C. Law

To contribute to a candidate or political committee at the federal, state or local level, you must be a citizen or a permanent resident (a green card holder) of the United States. If you contribute to a candidate or political committee, you must provide the committee with (1) your full name, (2) your address, (3) your employer's name and your occupation (although some jurisdictions do not require this disclosure) and (4) the date you contribute. If you contribute over certain thresholds, this information will be publicly disclosed on the political committee's campaign reports.

Donating goods or services to a candidate or political committee is likely to be considered an in-kind contribution subject to contribution limits. For example, if you donate food or beverages to a campaign, the value of the goods provided likely will constitute an in-kind campaign contribution. There are limited exceptions to this rule (click applicable link for federal exceptions; California exceptions). Note that many jurisdictions also will count the contribution of a business entity that you control against your individual contribution limit.

Additional restrictions may apply for public contractors or those attempting to become public contractors, lobbyists or certain other professionals in highly regulated industries with regular interaction with government agencies.

This summary is not a comprehensive overview of campaign finance law. We can assist you in complying with state and federal campaign finance laws, including California's major donor filing requirements.

Changes in California Property Tax Law: Planning Opportunities With Principal Residences

The passage of Proposition 19 by California voters in November 2020 made significant changes to the exemption from property tax reassessment for transfers between parents and children. (Read our November 2020 alert here.) Before the passage of Proposition 19, the transfer of a principal residence between a parent and child could be fully excluded from property tax reassessment, regardless of the market value of the property or whether the child subsequently used the property as a principal residence or for some other purpose. Under the previous exemption, children not only received the benefit of the existing taxable value of the property but could also pass some or all of that benefit along to their own children. Prior to Proposition 19, it was beneficial for property tax purposes to own a principal residence directly through a living trust so that the parent-child exemption could be used to fully exempt the residence from property tax reassessment.

Proposition 19 repealed the existing parent-child exemption and replaced it with a much more limited one. Beginning with transfers occurring on or after Feb. 16, 2021, the parent-child exemption is limited to transfers of a principal residence that at least one of the transferee children will use as a principal residence, as well as to certain farm property. In addition, even if a transfer qualifies for the exemption and the property will continue to be used as a principal residence by a child, a principal residence with a fair market value in excess of the residence's current assessed value as of the date of transfer, plus $1 million (adjusted for inflation), will trigger a partial property tax reassessment. Given these limitations, the new parent-child exemption is likely not going to be available in most cases where children inherit a principal residence.

To preserve the assessed value of the principal residence when it is transferred to children (typically at death), you should consider forming a limited liability company owned by your living trust to be the direct purchaser of the residence. For California real property where a business entity, such as an LLC, is the original purchaser, a transfer of all or any portion of the LLC interests will generally not cause a "change in ownership" triggering a reassessment unless the transfer causes any person to obtain, directly or indirectly, more than 50% of the ownership interests in the entity (called the "change in control" rule). In the case of an LLC or partnership, control is measured in economic terms by ownership of more than 50% of the total partnership capital and more than 50% of the total partnership profits; the actual control of management decisions by a manager, the general partner, or other partners or members is not relevant. For purposes of applying the "change in control" rule, there is no attribution of ownership between family members or other related persons. With respect to trust owners, an interest held by a revocable trust is treated as being owned for property tax purposes by the trust settlor(s) who have the power to revoke the trust, and an interest held by an irrevocable trust is treated as being owned by the current beneficiary(ies) of the trust.

When an LLC is the original purchaser of a California residence (or any other real property), the property is not reassessed at the death of the first spouse even though the surviving spouse will come to own 100% of the LLC because the inter-spousal exclusion applies and trumps the change in control rule. When the surviving spouse dies and the LLC interest passes to at least two children, as long as no child comes to own more than 50% of the LLC (whether directly or through an irrevocable trust for the child's benefit), there would be no reassessment of the property. This same planning works if the property will pass to beneficiaries other than children, as long as no beneficiary comes to own a more than 50% interest in the LLC.

This same planning will not work, however, if you first purchase the residence in your individual name(s) or through your living trust and then contribute the property to an LLC that you wholly own. In that scenario, in addition to the change in control rule described above, the property will also be reassessed when more than 50% of the LLC interests have been transferred, cumulatively (excluding transfers to spouses). For a residence or other property contributed to an LLC, the transfer of the LLC interests at the death of the second spouse would trigger a reassessment (even if no single beneficiary receives more than 50% of the LLC in the transfer), as would transfers during your lifetime of more than 50% of the LLC interests. This cumulative 50% transfer rule does not apply when the LLC or other legal entity is the original purchaser of the property.

As with all planning, there are other factors you should consider in deciding whether to acquire a principal residence through an LLC. For example, since a residence is not income producing, the lender may require that the LLC owners guarantee any mortgage debt, which is generally undesirable since it causes otherwise nonrecourse financing secured by the residence to become recourse to the LLC owners. Some banks may also charge a higher interest rate on the mortgage if the residence is purchased through an LLC. New federal requirements for reporting the beneficial ownership of entities, including LLCs, also may soon apply. (Read our article "New Beneficial Ownership Reporting Requirements for Privately Held LLCs and Other Entities" here.) But depending on your circumstances and overall goals, acquiring your residence through an LLC may be a powerful way to generate significant and long-term property tax savings when the residence passes to your children.

Reminders - 2022 Adjustments in Transfer Tax Exemptions and Interest Rate

The following 2022 federal tax information may be helpful as you consider your estate planning options for the rest of the year. You should contact your Loeb estate planning attorney for advice before making any taxable gift or intra-family loan.

2022 Transfer Tax Exclusions and Exemptions

- Gift Tax Annual Exclusion – $16,000 (increased from $15,000)
- Gift/Estate Tax Exemption – $12.06 million (increased from $11.7 million)
- Generation-Skipping Transfer (GST) Tax Exemption – $12.06 million (increased from $11.7 million)

Gift Tax Annual Exclusion. The annual exclusion is the most you can give to or for the benefit of an individual within a calendar year without reducing your lifetime gift tax exemption, paying gift tax or filing a federal gift tax return. Married couples can effectively double the annual exclusion amount (to $32,000 per recipient) by electing on a gift tax return to "split" gifts.

Gift/Estate and GST Tax Exemption. Gifts in excess of the annual exclusion reduce the donor's available lifetime gift tax exemption and must be reported on a federal gift tax return. Gift tax exemption used during life reduces the federal estate tax exemption available at death to offset federal estate taxes. A GST tax also may apply to gifts or bequests to "skip persons" (grandchildren or more remote descendants) or trusts where all current beneficiaries are skip persons). Application of the GST tax exemption can shield these transfers from GST tax.

Unless the tax laws change, the lifetime gift/estate and GST tax exemptions are scheduled to decrease in 2026 to $5 million (estimated at $6.2 million when adjusted for inflation).

7520 Rate and AFRs. Certain estate planning techniques, such as grantor retained annuity trusts (GRATs), charitable lead annuity trusts (CLATs), and intra-family loans and installment sales, are more attractive when certain federally set interest rates are low, specifically the §7520 rate for GRATs and CLATs and the applicable federal rate (AFR) for intra-family loans and installment sales. These rates have risen over the past several months (compare rates for May and June 2022 below).

		May			June	
7520 Rate:		3.0%			3.60%	
AFRs:	**Short-Term**	**Mid-Term**	**Long-Term**	**Short-Term**	**Mid-Term**	**Long-Term**
Annual	1.85%	2.51%	2.66%	2.21%	2.93%	3.11%
Semiannual	1.84%	2.4%	2.64%	2.20%	2.91%	3.09%
Quarterly	1.84%	2.48%	2.63%	2.19%	2.90%	3.08%
Monthly	1.83%	2.48%	2.63%	2.19%	2.89%	3.07%

Related Professionals

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