

The Rodi Review

Summer 2006

LETTER FROM THE EDITOR

Welcome to the Summer 2006 issue of the Rodi Review. In this issue, Bill Christian analyzes whether you should review your estate plan in light of changing estate tax laws; Al Klein discusses some key issues which should be of great interest to anybody employing an in-home caregiver, and Cris O'Neal provides some tips for minimizing the property tax burden on commercial real property. We hope you have a sun- and fun-filled summer!

Jean M. Beasley
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BEWARE THE CAREGIVER!

By Alfred Klein

A growing number of elderly individuals are hiring live-in caregivers, housekeepers or companions to help them remain in their homes during their "golden years." Although these helpers usually provide an invaluable service, it is important to address a number of issues prior to engaging their services. In particular, unless the helper is in the employ of an agency, the terms of his or



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DO TAX CHANGES MEAN YOU SHOULD RE-VISIT YOUR ESTATE PLAN?

by William R. Christian

Since 2001 the federal estate tax law has dramatically changed the amount of a decedent's estate that will pass free of any estate tax, rising from \$675,000 in that year to its current

... many affluent couples can now expect to fall below the estate tax radar.

level of \$2,000,000. Because this applicable exclusion amount doubles for married clients, many affluent couples can now expect to fall below the estate tax radar.

Historically, married couples have relied on the use of a "bypass trust" to save estate taxes, combining the

unlimited marital deduction with the applicable exclusion amount (now \$2 million). This approach may still be the recommended one for those clients whose estates exceed the current and projected exclusion amounts.



Upon the death of the first spouse the Trustee deposits the full exclusion amount into a "bypass" trust and the balance of the trust pass to the surviving spouse in a manner qualifying for the marital deduction. No tax is due at the first death, and the bypass trust amount, after providing for the surviv-

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MINIMIZING PROPERTY TAXES ON IMPROVEMENTS

by Cris K. O'Neill

Virtually all commercial real estate contains some form of tenant or leasehold improvements.

Despite the prevalence of such improvements, however, many commercial property owners and tenants do not understand how those improvements can affect their property tax bills. The result can be an over assessment of the property by the local Assessor.

Owners and tenants alike should be aware of two primary pitfalls that can cause them to pay higher property taxes than are warranted:

First, property owners and tenants may fail to identify in their lease or rental agreement who the owner of the improvements will be. As a result, confusion can arise as to where the responsibility lies for reporting to the local property tax assessor any new improvements or changes to existing improvements.

For example, a tenant may report the estimated value of new improvements on a building construction permit. The property owner may report the cost of the same improvements on the annual property rendition to the local assessor. Because assessors review both building permits and annual renditions, such double reporting can result in over- or even double assessment of a single improvement.

Alternatively, the assessor may determine the value of the improvements from the building permit instead of relying on the annual property rendition which reports the actual cost of the improvements. If the person completing the building permit has overestimated the cost of the improvements, over-assessment can occur.

A second event that may cause over assessment is the incorrect classification of improvements. Recently installed improvements can be classified as either new construction or regular maintenance. The former is subject to reassessment, while no assessment at all will occur on the latter. Similarly, the classification of construction improvements, either as "structure" or as "fix-



... confusion can arise as to where the responsibility lies for reporting to the local property tax assessor any new improvements or changes to existing improvements.

tures," will determine the amount of the assessment on those improvements and the amount of property taxes due.

To complicate matters further, more than one unit or division of a particular assessor's office may share the responsibility for assessing improvements. In addition, the assessor's offices statewide have adopted no uniform procedures or policies to follow in assessing improve-

A basic understanding of how improvements are assessed can go a long way toward reducing the property tax assessments on such improvements for years to come.

ments. A survey of assessors conducted by the California State Board of Equalization in December 1999 showed that many assessor's offices (a) have no written procedures for assessing improvements, (b) have no set standard for classifying improvements as structures or fixtures, and (c) assess improvements to owners or tenants

depending on the circumstances specific to that property.

Here are some suggestions for avoiding over assessment and the accompanying overpayment of property taxes:

1. Agree upon who owns the improvements (property owner or tenant) and charge the owner with reporting both new improvements on building permits and additions or deletions on the annual property rendition. The lease should indicate the owner of the improvements (based upon whether a portion of the lease payments recoup the cost of improvements). Making the party who owns the improvements responsible for reporting to the local assessor's office will reduce the chance of inconsistent reporting, the primary cause of over-assessment.
2. Determine whether the improvements are new construction (which is assessable) or normal maintenance and repair (which is not). As a general rule, an improvement item that is capitalized for tax purposes is new construction. Furthermore, any addition, alteration, modernization, rehabilitation or renovation that makes the property "substantially equivalent to new" is new construction. Conversely, if an improvement is expensed, that is, the costs are deducted currently, it is probably a non-assessable maintenance or repair item.
3. Know whether the leasehold improvement is a "structure" or a "fixture." Flooring, store fronts and light fixtures (in spite of their name) are examples of structure items. Fixtures include electrical wiring, rough plumbing, sinks and counters (pertinent regulations contain lists of items considered to be fixtures). The local assessor uses annual "trend tables" to

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her employment may violate federal and state employment laws.

Many clients enter into caregiving arrangements without *any* written agreement setting forth compensation, hours required or even a job description. Doing so can expose the client to significant financial liability, either to the helper or to the state or federal government.

Accordingly, whoever engages the live-in helper — whether the elderly client or the client's agent or family — must address and resolve several critical issues:

EMPLOYEE OR INDEPENDENT CONTRACTOR?

Live-in helpers often prefer to be paid in cash or by personal check without any payroll deductions. For that

purpose, they may claim to be independent contractors. In fact, such helpers are independent contractors only when they are employees of an agency that carries workers

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compensation insurance and makes all required statutory deductions for taxes. In those cases, the agency, not the individual, is the independent contractor.

A written or oral agreement alone cannot establish an independent contractor relationship. Under California law, a person must be running an independent business with investment of capital in the business in order to qualify as an independent contractor. Any

individual providing live-in home care directly cannot satisfy this requirement.

Numerous liability issues arise when a live-in helper is wrongly treated as an independent contractor:

LIABILITY FOR ON-THE-JOB INJURY

The most catastrophic liability can derive from an uninsured workers compensation claim. Workers compensation insurance is usually included in homeowners insurance policies, but in an excess of caution the client should confirm that the live-in caregiver is fully covered by a workers compensation policy.

In a recent case a caregiver was involved in a minor household accident and sued two elderly clients who had no workers compensation insurance coverage. Although in fact the caregiver had

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ing spouse for his or her lifetime, passes tax-free to the couple's named beneficiaries at the second death. At the survivor's death, his or her estate is entitled to claim the exclusion amount then in effect, significantly reducing or eliminating the federal estate tax.

The use of the bypass trust to hold the exclusion amount may now be less compelling for clients with more modest estates. For example, a couple with a total community estate of \$1,800,000 may conclude that the bypass trust is unnecessary because the applicable exclusion amount would shelter the *entire* community estate from estate taxes. Avoiding a bypass trust would also relieve the Trustee from the need to administer a second trust.

Because the federal estate tax law appears to be in transition, and not

even the members of Congress can predict the outcome, those couples who now fall somewhere in the non-taxable category may still want to hedge their bets by at least making use of a "disclaimer trust," instead of a bypass trust. The trust instrument would leave the entire estate directly to the surviving spouse but confer upon him or her the power to disclaim — without any tax

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consequences — all or a portion of the deceased spouse's property into a trust for the surviving spouse's lifetime benefit. The disclaimer trust would qualify for the shelter of the exclusion amount, ensuring that the assets would escape estate taxation at the survivor's death.

It is not uncommon, even when disclaiming will result in lower taxes, for the surviving spouse to elect to receive the entire estate outright in order to minimize complications. Herein lies the

disadvantage of the disclaimer trust: The deceased spouse cannot impose otherwise sound tax planning upon the surviving spouse.

Even where a couple has a more substantial estate, if the bypass or disclaimer trust passes directly to their children (or others) at the first death, the couple may want to limit that amount. An estate plan leaving the deceased spouse's entire exclusion amount to the children at the first death may have made sense when the exclusion amount was \$675,000. Under current law, however, such a plan could dramatically reduce the survivor's resources or might even eliminate the bypass amount for the survivor.

As a general rule, clients should review their estate planning documents every two to three years to make certain that family or other changes do not require an update. Continued changes in the federal estate tax laws make such a review all the more compelling.

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suffered no real injury, she was able to establish that she had suffered permanent injuries, and the clients were forced to settle with the caregiver.

LIABILITY FOR FAILURE TO COMPLY WITH STATUTORY REQUIREMENTS FOR EMPLOYMENT

When the client has failed to treat a caregiver as an employee, the caregiver can seek fines for being paid in cash, can file for unemployment insurance when his or her client dies or moves to an assisted living facility and can assert an action for the client's failure to withhold income taxes when the omission is later discovered in a tax audit. The client can mount no legal defenses to any of these actions.

The California Labor Commissioner can (and does) levy significant penalties for not making proper payroll deductions. The Employment Development Department can charge an employer for all unemployment insurance benefits, payroll taxes and unpaid personal income taxes. Finally, the Internal Revenue Service is also entitled to assess substantial penalties for failure to withhold for income, Social Security and Medicare taxes.

WAGE AND SALARY ISSUES

For employment purposes, an employee's status as a personal attendant, or companion, or as a housekeeper or other type of employee, can materially affect the compensation to which the caregiver is entitled. Under California and Federal law, a live-in personal attendant or companion engaged predominantly in caregiving and companionship activities does not have to keep track of his or her hours, and is not entitled to overtime compensation. By contrast, housekeepers, gardeners or other home servants are treated as regular employees who must submit time records, and are entitled to

overtime for hours worked in excess of the statutory limit.

In a recent case, a caregiver for an Alzheimer's patient claimed she was entitled to nearly *one million dollars* in overtime because she worked 24 hours a day,

The most catastrophic liability can derive from an uninsured workers compensation claim.

seven days a week for five years. She claimed she was not an exempt personal attendant or companion for the elderly gentleman because she also cooked breakfast daily for his wife, helped her entertain at parties several times a month, ran shopping errands for her, cleaned the house and did laundry for her

A job description must be an integral part of the written employment agreement, and that job description should clearly state that the employee, if a live-in, is not a tenant.

son and grandchildren when they visited. Although she did not prevail, under other circumstances the claim could have resulted in ruinous liability to the client.

AN OUNCE OF PREVENTION

Preventative actions during the hiring process can obviate the kinds of problems discussed above. The client should run a litigation and credit check as part of the vetting process. A person who has a history of suing people, especially her clients, or who has debt problems, presents a serious risk of theft as well as a lawsuit.

When engaging a fulltime caregiver, the client should consult with an employment lawyer to review whether the compensation arrangement is proper, whether workers compensation insurance coverage exists and whether the new employee is an exempt personal attendant or employee. The job description should

clearly state that the employee, if a live-in, is not a tenant. In a recent case, when a grandchild took over the care of his grandfather, the live-in caregiver refused to leave, claiming that she was a tenant.

If the employee is not an exempt personal attendant or companion, the employment agreement must require the employee to submit a signed weekly time sheet, which becomes the basis of a payroll check complying with all legal requirements, such as a pay stub that shows deductions, the correct legal name of the employer, straight time and overtime hours and other requirements. The employment agreement must also define any entitlement to severance pay upon the death of the person being cared for.

The death of an elderly parent or other loved one can be devastating. The safeguards discussed above will minimize the likelihood of disputes with caregivers and home employees concerning the terms of severing their relationship or unmeritorious claims by an unscrupulous, formerly trusted employee, and thus will avoid adding insult to injury.

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determine the depreciation schedule for "structure" items. In contrast, fixtures are not depreciated: the assessor assigns a "base-year" value that may only increase a maximum of two percent annually under Proposition 13.

Commercial property owners, tenants and managers should keep the above in mind as they address improvement issues. A basic understanding of how improvements are assessed can go a long way toward reducing the property tax assessments on such improvements for years to come.