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ATTORNEYS AT LAW

NEWSLETTER

THIRD/FOURTH QUARTER 2011

TIS THE SEASON...FOR GIFTING

By Megan M. Lewis

As the end of the year rapidly approaches, gifting is at the forefront of my personal and professional activities. My strategies on choosing white elephant gifts are of minimal use, but I hope my thoughts on current estate and gift tax issues are useful to you.

With our current estate and gift tax structure, set to change completely at the end of 2012, there are a number of issues and opportunities: (1) the "annual exclusion amount" each taxpayer may gift to anyone without tax implications, (2) the current amount a person can leave behind at their death without paying estate tax is $5 million per person under federal law and $2 million per person under Washington state law, (3) a person may gift their $5 million allotment while they are still alive, not just after they die, and (4) the federal amounts can be combined (through "portability") to transfer $10 million per married couple, but not without jumping through some hoops.

This time of year, people talk to each other and listen to news outlets intently, trying to find wise year-end financial moves. I'm often asked if I can put documents together to make a gift of business or property interests with very short deadlines because the client has just heard of a particular tax-savings method. While I can generally act quickly, it is often in the client's best interest to slow down and discuss their entire estate and ultimate goals for succession first to see if such a gifting plan would serve them well or cause them an unnecessary expense.

In 2011, the amount an individual is allowed to gift with no tax consequences is $13,000 per person. This will stay the same for 2012. These annual gifts must be of "present interests" and not "future interests." Generally, the most useful appropriate assets to gift on an annual basis are business ownership interests. The major benefits of gifting business interests in small amounts is that the Internal Revenue Service (IRS) recognizes discounts on the value of those interests for "lack of marketability" and "minority interest" holders. Simply put, the per unit

Continued on Page 2

IN THIS ISSUE

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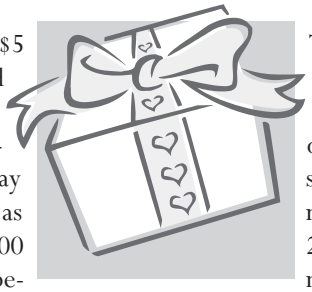
GIFTING — CONTINUED

value of the 2% of LLC ownership you give to your children isn't worth as much as the 98% you retain because they own a small fraction and there are generally many restrictions on what the recipient can do with the units or stock under the terms of the LLC Agreement or Bylaws. The discounts range depending on a number of factors, but can typically reduce the value of the business interest by something around 20% to 40%. This way, you, the taxpayer, can transfer more to your children in business interests than you could in cash. This is attractive because, more often than not, our clients have more business units available to gift than they do cash. Sound familiar?

There is one important caveat to gifting business interests in that sometimes the IRS will reject the gift as being a gift of a future interest if there are too many restrictions on ownership/transfer. We do have options to turn these future interests into present interests by giving the recipient a short period in which to redeem their gift for cash; so if you are interested in utilizing this technique, it is important that your business documents are current and follow these requirements.

Despite the attraction of this "annual exclusion," a major issue we look at is whether it will make a significant difference for our clients. This is where we get into the discussion of overall net worth. For Washington state purposes, a person can leave behind $2 million without paying state estate tax and the federal level is $5 million in 2011 and $5,120,000 in 2012 (let's still call it $5 million). Under the federal rules, this is called the "unified credit amount." So, if your net worth is under $2 million and you don't foresee reaching that amount, you are blessed with not having to worry about gifting. If your estate is between $2 million and $5 million (at your death), you might want to make some gifts during your lifetime to reduce your estate to avoid any concerns about either state or federal estate tax.

However, for 2011 and 2012 you are allowed to gift up to $5 million during your life without paying gift tax (yes, a separate federal tax from the estate tax), but it will use up part of the $5 million you can leave upon your death. So, this is how you can give away much more than $13,000 to one person right now without owing any tax (gift or estate), but you are supposed to file a gift tax return to notify the IRS that some of your $5 million unified credit amount was used.



If you fall into the $2 to $5 million range, it would be a good idea to make some gifts, perhaps significant gifts, but you may not need to worry as much about the $13,000 per person per year because you can accomplish your gifting to reduce your estate below the taxable amount without incurring additional gift tax. There is also no gift tax in Washington state. If your estate is above $5 million, you may at that point want to start an annual program under which you gift the $13,000 amount to your children or in a trust outside of your estate for the benefit of your children, as well as some larger gifts. It may also be a good idea to start an annual gifting program if you have more than $2 million and less than $5 million, but are relatively young and can end up transferring a significant amount of your wealth over a long period of time. This would also hedge against the probability that your estate is likely to grow significantly over time. Although great growth seems unlikely with the current economy, I'm optimistic, or maybe just young and foolish.

Another element that may change on January 1, 2013, or before, is the "portability" of one spouse's $5 million exemption to the other spouse. Currently, when the first spouse dies, an estate tax return must be filed, even if no tax is owed, and the surviving spouse must elect to transfer the deceased spouse's exemption to themselves. However, not only is this rule set to expire, but the surviving spouse may loose the deceased spouse's exemption if he or she remarries. Also, the portability does not apply to the Washington state estate tax, which, remember, has the lower exemption amount of $2 million.

Timing your gift correctly is tricky because the $5/$10 million deal is a limited time offer from Congress which is set to drop back down to $1 million on January 1, 2013. However, Congress may act to extend these amounts for additional years, change the allowable amount, or fail to act and allow the exclusion to drop back to $1 million. Since Congress could act to make a change at any time, if you are interested in gifting to reduce your estate, it may be best to get it done as soon as possible.

Before the days of "portability" (pre-2011), estate planners already had a technique to utilize the exemption amount of the first spouse to die by creating a structure of trusts which came into being upon the first death to hold the amounts allowed to be passed without estate tax by the decedent while still giving the surviving spouse access to and

Continued on Page 3

GIFTING — CONTINUED

use of the assets. These same trusts also partition off the amounts free from Washington estate tax. Many estate planners wisely continue to use these trusts given the uncertainty of the future rules. While we don't like to depend on the rules staying the same, it is a great time to take advantage of the current rules to make large gifts to reduce the size of your estate or set up an annual gifting plan to keep from exceeding the limits.

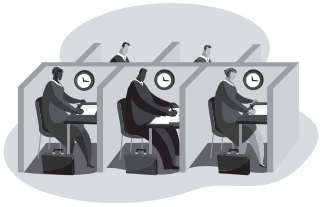
As always, the one-size-fits-all gift rarely does. Be sure to consult your business, estate, and tax professionals to help you craft a plan that will pass your family business and estate value on to your future generations systematically and purposefully, and limit the amount of tax paid in the process.

REMINDER—NATIONAL LABOR RELATIONS ACT APPLIES TO NON-UNIONIZED EMPLOYERS

By Kirsten Barron

The National Labor Relations Board ("NLRB") continues to find that certain employer policies violate the National Labor Relations Act (the "Act"). Employers are often surprised to discover that the Act applies to almost all employees who are not in management or supervisory roles. Employers can easily find themselves in violation of the Act with some quite common employment policies.

An employer cannot adopt a rule or policy that in practice would quell concerted activity or unionization. For example, many employers prohibit their employees from discussing wages. Such a prohibition is in violation of Section 7 of the Act. Section 7 provides that "employees shall have the right to self-organization, to form, join or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities . . .." If an employer prohibits discussion of employee wages among the employees, the employer is arguably preventing concerted activity among employees with regard to bargaining about wages – which is a key issue in the employment relationship. Employers will tell me that they are trying to avoid office politics and controversy by imposing such a restriction – it is nevertheless most likely an illegal practice. Another example that would quell concerted activity or unionization is a rule against striking or joining a union.



Another way to run afoul of the Act is to impose restrictions on employees' communications with other employees if the employees are engaging in concerted activity. An employer can find itself in trouble if employees engage in concerted activity or unionize and the employer attempts to prevent communication between the employees about the possible concerted activity or unionization when it has allowed other non-work-related communication among employees in the past. Employers sometimes attempt to curb concerted activity and discussion among employees on a particular issue by adopting a rule prohibiting the use of company property for non-work purposes. If such a rule is adopted in response to concerted activity, it is likely the rule will be invalid. An employer generally cannot adopt a rule or policy in response to concerted activity or unionization that attempts to quell that activity.

Lastly, employers should be aware of overly broad policies that could inhibit or discourage an employee from asserting their rights under the Act. For example, a rule that prohibits negative conversations about owners or managers could be interpreted to inhibit concerted activity among employees about working conditions.

Even though an employer may be a non-unionized workforce, the Act can apply in surprising ways.

2012

MINIMUM WAGE INCREASE

Effective January 1, 2012, Washington's minimum wage will increase to $9.04 per hour.

According to the Washington State Department of Labor & Industries, Washington's minimum wage applies to workers in both agricultural and non-agricultural jobs, although 14 and 15-year-olds may be paid 85 percent of the adult minimum wage, or $7.68 in 2012.

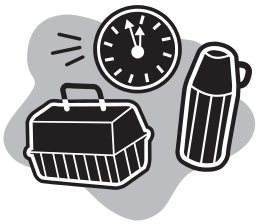
Did you know…

- ◊ Washington is one of 10 states that adjusts the minimum wage based on inflation and the Consumer Price Index (CPI).
- ◊ Washington state has the highest minimum wage, followed by Oregon.

UPDATE—WASHINGTON EMPLOYEES ENTITLED TO ADDITIONAL PAY IF WORKING DURING A MEAL PERIOD

By Kirsten Barron

In Washington, an employee generally must be provided an unpaid meal period of at least 30 uninterrupted minutes for shifts exceeding 5 hours, as well as an unpaid 10 minute rest break for every 4 hours of work. Employees are allowed a meal period of at least 30 minutes that commences no less than 2 hours nor more than 5 hours from the beginning of the shift. (WAC 296-126-092). The Washington State Court of Appeals has addressed the issue of remedy when there is a violation of this law. The Court ruled that an employer who pays its employees during meal periods and does not provide uninterrupted time away from duties to take the meal period is required to pay the employee for the missed meal period.



In *Pellino v. Brink's Incorporated*, decided in November 2011, the plaintiff claimed she and a group of employees were denied the required meal and rest periods under Washington law because the employees were required to remain vigilant at all times – observing their surroundings, anticipating and taking every possible protection and being constantly suspicious of other vehicles and pedestrians, even those who appear to be police officers or store employees. The employee handbook prohibited any personal business while on duty except eating, drinking and smoking in the truck.

The company's position was that the nature of armored car deliveries, during which the driver and crew must constantly secure the car and its contents, allowed little downtime for breaks. In lieu of providing meal and rest breaks, the company simply paid the drivers for a full day's work (including time that would otherwise have been spent on meal and rest break periods) and allowed them to stop for meals and breaks as their delivery schedules allowed.

The trial court determined there was little to no time when employees could actually take a break and relax; employees' assigned routes often made it impossible to take a break and employees were encouraged to eat on the go. Division I of the Court of Appeals affirmed the trial court's decision. The Court of Appeals held that if the 30 minute meal period is interrupted because the employee has to perform a task, Washington law requires that the employee be paid for the entire 30 minutes worked *and* the meal period be continued until the employee has received 30 minutes total of mealtime. In this case, the remedy for failing to provide the 30 minutes of time was to pay the employees for an extra 0.5 hour each day of work – in this case $2.1 million back pay, accrued interest, and attorney fees.

Many smaller employers do not pay for meal periods; however, the implication of this decision is that if an employer does not allow an employee a meal period, the remedy is that the employer pays for that time. For example, an employee works from 8:30 to 5 with a 0.5 hour unpaid meal period. However, due to the employer's directives, the employee is not able to take that 30 minute period. The remedy is that the employee is paid for an extra 30 minutes of time. In this example, the employee worked 8.5 hours, but is paid for 9 hours as a remedy for not getting his meal period.

Often an employee will ask to work through his or her meal period to leave early for an event or appointment. While Washington law allows an employee to waive a meal period, the Washington State Department of Labor and Industries has stated that such a waiver should be in writing. A written waiver is not required under Washington law, but is strongly advised to avoid misunderstandings. The Washington State Department of Labor and Industries has provided guidance on meal periods. See http://www.lni.wa.gov/WorkplaceRights/files/policies/esc6.pdf.

The *Pellino* decision is on appeal to the Washington State Supreme Court.

AMENDMENTS TO THE CHARITABLE SOLICITATIONS ACT

The Charitable Solicitations Act, 19.09 RCW, was amended during the 2011 Legislative Session. Some of the changes include:

- ◊ Organizations that raise less than $50,000 are not required to register if all the activities are carried out by persons who are unpaid for their services. (Threshold was increased from $25,000 to $50,000.)
- ◊ Organizations required to register are no longer required to attach a copy of their Federal 990, 990EZ, or 990PF with the annual registration.
- ◊ Organizations are no longer required to attach a copy of the audited financial statement, if previously required.

To view a summary of all the changes, please visit the Charities web page at: http://www.sos.wa.gov/charities

A PERSONAL NOTE FROM THE DEPARTMENT:

By Kirsten Barron

I have spent a lot of my "Personal Note" space in the last couple of years talking about the economy, which has a significant effect on my practice, on my clients and me, and on this community. While there are certainly some hopeful signs, there continue to be harbingers of more of the same. In short, times remain uncertain.

The law firm has adopted a motto that has served us well during difficult times. Many of you may know of Ernest Shackleton, but for those who do not, this is worth a few lines. Shackleton was a great polar explorer whose failure ended up being one of the world's most heroic achievements. He went off to be the first explorer to cross the Antarctic – from sea to sea. About 6 weeks into the expedition, his ship, the Endurance, was caught in pack ice and eventually crushed by the ice. He and his men then lived on an ice flow for 2 months. Seven months after the journey began, the entire crew was finally rescued – and Shackleton did not lose a man. He lost his fingers because he gave his gloves away – he lost sleep because he had the most annoying crew member in his tent – but he did not lose a man. He said, "[o]nward we go certain only of further difficulty." I have found this quotation inspiring, because it is in the "onward we go" where I find inspiration. And the firm, as well, has headed "onward" – and despite the difficulties of this economy, our journey is bearing fruits.

Speaking of bearing fruits, we are delighted to have the contributions of Scott Caldwell to our newsletter this month. Scott and his wife recently welcomed a baby boy – and Scott has also provided an article on Business Succession Planning. See attached. Scott is a financial advisor with Waddell & Reed, and I very much appreciate the "non-lawyer" perspective of this important part of running a business.

Sallye Quinn has been appointed as the new Managing Partner for the law firm. We are very excited for the skills and abilities she will bring to the firm in this new role.

You may have seen our press release about the firm being selected by US News and World Report as one of the United States' best law firms in trusts and estates. Many congratulations to our trusts and estates folks on this remarkable achievement.

Megan Lewis has joined the firm. She comes to us from Jeffers, Danielson in Wenatchee. As an associate, she is working with all of the lawyers, but she focuses her practice in trusts and estates. She has an LLM in taxation, which adds to her ability to provide clients a full range of trusts and estates services.

Despite the difficulties – onward we go – and we are grateful for these wonderful happenings. I know from talking with you, clients and colleagues, that your experiences are similar. Despite the uncertainty and difficulty, good things are happening.

Enjoy the journey (and the holidays) despite the difficulties.

Kirsten Barron

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Business Succession Planning

When developing a succession plan for your business, you must make many decisions. Should you sell your business or give it away? Should you structure your plan to go into effect during your lifetime or at your death? Should you transfer your ownership interest to family members, co-owners, employees, or an outside party? The key is to pick the best plan for your circumstances and objectives, and to seek help from financial and legal advisors to carry out this plan.

Selling your business

Selling your business outright

You can sell your business outright, choosing the right time to sell--now, at your retirement, at your death, or anytime in between. The sale proceeds can be used to maintain your lifestyle, or to pay estate taxes and other final expenses. As long as the price is at least equal to the full fair market value of the business, the sale will not be subject to gift or estate taxes. But, if the sale occurs before your death, it may result in capital gains tax.

Transferring your business with a buy-sell agreement

A buy-sell is a legally binding contract that establishes when, to whom, and at what price you can sell your interest in a business. A typical buy-sell allows the business itself or any co-owners the opportunity to purchase your interest in the business at a predetermined price. This can help avoid future adverse consequences, such as disruption of operations, entity dissolution, or business liquidation that might result in the event of your sudden incapacity or death. A buy-sell can also minimize the possibility that the business will fall into the hands of outsiders.

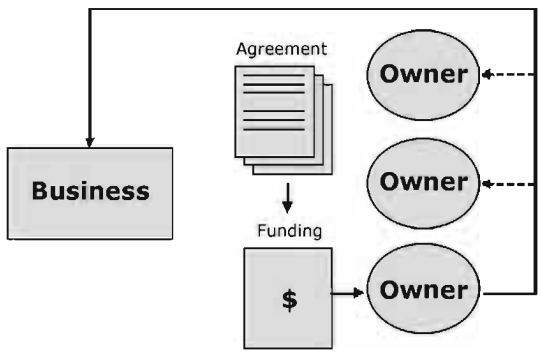
The ability to fix the purchase price as the taxable value of your business interest makes a buy-sell agreement especially useful in estate planning. Agreeing to a purchase price can minimize the possibility of unfair treatment to your heirs. And, if your death is the triggering event, the IRS' acceptance of this price as the taxable value can help minimize estate taxes.

Additionally, because funding for buy-sells is typically arranged when the buy-sell is executed, you're able to ensure that funds will be available when needed, providing your estate with liquidity that may be needed for expenses and taxes.

Common business succession planning objectives

- *Ensure smooth, seamless transfer of ownership*
- *Transfer business to next generation*
- *Ensure business continuity*
- *Retire with income source*
- *Minimize gift and estate taxes*

How a Buy-Sell Agreement Works



1. *Buy-sell is established with a separate agreement or is created by including buy-sell provisions in a business' operating agreement.*
2. *The plan is generally funded in some manner.*
3. *Upon a triggering event (as defined in the agreement), an owner's interest is purchased by either the business itself or the other owners. Price is determined according to the terms of the agreement.*

The key is to pick the best plan for your circumstances and objectives, and to seek help from financial and legal advisors to carry out this plan.

Private annuity

With a private annuity, you transfer your ownership interest in the business to family members or another party (the buyer). The buyer in turn makes an unsecured promise to make periodic payments to you for the rest of your life (a single life annuity) or for your life and the life of a second person (a joint and survivor annuity). Again, because a private annuity is a sale and not a gift, it allows you to remove assets from your estate without incurring gift or estate taxes. In addition, because you receive payments over the span of your life, you can spread any gain recognized on the sale, deferring capital gains taxes until years in which you may be in a lower tax bracket.

The catch to a private annuity arrangement is that because the buyer's promise to pay must be unsecured if you want to enjoy the tax savings, you may lose your income stream if the buyer fails to pay.

Self-canceling installment note

A self-canceling installment note (SCIN) allows you to transfer your interest in the business to a buyer in exchange for a promissory note. The buyer must make a series of payments to you under that note, and a provision in the note states that at your death, the remaining payments will be canceled. Like private annuities, SCINs provide for a lifetime income stream and they avoid gift and estate taxes. But unlike private annuities, SCINs give you a security interest in the transferred business.

Gifting your business

If you're like many business owners, you'd prefer to have your children inherit the result of all your years of hard work and success. Of course, you can bequeath your business in your will, but transferring your business during your lifetime has many additional personal and tax benefits. By gifting the business over time, you can hand over the reins gradually as your offspring become better able to control and manage the business on their own, and you can minimize gift and estate taxes.

Gifting your business using trusts

You can make gifts outright or use a trust. You can even structure a trust so that you keep control of the business for as long as you want. You can establish a revocable trust, which will bypass probate and allow you to change your mind and end the trust, or an irrevocable trust, such as a grantor retained annuity trust (GRAT) or a grantor retained unitrust (GRUT) that can provide you with income for a specified period of time and move your business out of your estate at a discount.

Gifting your business using a family limited partnership

You can transfer your business interest using another entity, such as a family limited partnership (FLP). An FLP is a limited partnership formed to manage and control a family business. You (and your spouse) can be the general partners, retaining control of the business itself and receiving income from the business, while your children can be limited partners. By transferring the business to an FLP, you may be able to use valuation discounts and substantially reduce the value of the business by making annual gifts to the limited partner children.

Gifting your business interests can minimize gift and estate taxes because:

- *It transfers the value of any future appreciation in the business out of your estate to your heirs. This can be especially valuable if business growth is expected.*
- *Gifts of $12,000 per recipient (in 2006) are tax free under the annual gift tax exclusion.*
- *Aggregate gifts up to $1 million are tax free under your lifetime exemption.*
- *Partial interest gifts, as with GRATs, GRUTs, and FLPs, may be valued at a discount for lack of marketability or restrictions on transferability.*

Disclosure Information -- Important -- Please Review