



## SIX DECADES OF MEETING CLIENTS' CHANGING NEEDS

As this issue of *Perspectives* demonstrates, the firm's expertise and experience cut across a number of practice areas and legal disciplines, from business law matters involving creditors' rights in bankruptcy cases to individuals' concerns regarding the status of the estate tax debate in Congress. During our 60 years as a law firm it has been our hallmark to make available to our clients expertise and experience that provide them value in their businesses and as well as in their personal business affairs. As the article on our firm's history reveals, our foundation was built initially upon the litigation talent and savvy of Luther Carr, the estate planning and probate process knowledge of Jed McClellan, and the business law acumen and personal charisma of Frank Ingersoll. "In the earlier days of practicing law within Carr McClellan," Frank Ingersoll would tell me shortly after he retired, "we only needed three code books, the Probate Code, the Civil Code and the Penal Code. Now we have a wall full of Codes." As the wall full of Code books grew (and then shrunk as libraries entered the digital age), the firm's areas of practice expanded to meet our clients' needs. The litigation practice expanded as areas such as estate and trust litigation became more specialized, as clients' needs for expertise and experience in real estate and construction disputes proliferated and as business disagreements became as complex as, well business agreements. The sophistication of estate planning techniques grew as our clients' successes allowed them to build wealth that needed to be protected for successive generations. Business law matters exploded into a myriad of sub-specialties that include entity formation and financing, mergers and acquisitions, tax, real estate, employment, intellectual property and more. While Carr McClellan still serves the needs of our clients in dispute resolution, estate and trust planning and administration, and business law matters, those areas have become more complex than ever before. Sixty years later, we continue to draw strength from the vision of our founders. They brought to the firms' clients the expertise they then needed; we now bring to our clients that expertise albeit with ten times the number of lawyers, an expanded menu of practice selections and a few more Code books to draw upon.

Mark Cassanego is President of Carr McClellan.

## ESTATE PLANNING - UNCERTAIN TIMES STILL CALL FOR CERTAIN ACTION

By Laurelle Gutierrez-Lundquist, Esq.

Benjamin Franklin once said, "In this world nothing can be said to be certain, except death and taxes." Death and taxes might be certain, but there seems to be little certainty when you combine the two – death taxes, or what is more properly called the estate tax. Over the past 200 years the U.S. Congress has enacted the federal estate tax five times and repealed it three times.

On April 14, 2005, the U.S. House of Representatives again voted to repeal the federal estate and generation-skipping transfer (the "GST") taxes, this time by voting to make permanent the repeal of those taxes under the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act"). And while President Bush fully endorses repeal, the real fight over repeal has occurred and will continue to occur in the U.S. Senate.

Supporters of repeal in the Senate have not been able to reach the 60-vote majority required for outright repeal. In light of that fact and given the ever growing concern over rising budget deficits, a compromise now is being discussed that would decrease the tax rate on estates or generation-skipping transfers, increase the exemption amounts for each of these taxes, or a combination of the two. With the possibility looming that Congress will finally provide some much needed certainty in the federal transfer tax system, those of you who might be contemplating making gifts to friends or family in the near future, planning your estate, or changing your existing estate plan are likely asking yourselves: Should I act now, or should I wait for the turmoil to pass?

If you wish to make the intended gifts or plan your estate *regardless of the transfer tax consequences*, by all means do it! If, on the other hand, you are concerned about the impact of the federal estate, gift and GST taxes on your plan of gifting or on your estate plan, then the answer of whether to wait or proceed is - proceed with caution. The 2001 Act set in place an extremely complex and perplexing transfer tax regime, one which will adversely affect nearly every person in America. In the event Congress votes to make permanent the repeal of the federal

see ESTATE PLANNING, page 7

### 2 BUSINESS LITIGATION

UNFAIR BUSINESS  
PRACTICES ACT

### 3 CREDITORS' RIGHTS

THE AUTOMATIC STAY

### 4 FIRM HISTORY

DRAWING STRENGTH  
FROM OUR PAST

### 6 REAL ESTATE

SPECIAL PURPOSE  
ENTITIES



## UNFAIR BUSINESS PRACTICES ACT - UNFAIR TO SOME BUSINESSES

By Lori Lutzker, Esq.

California's "Unfair Business Practices Act" prohibits "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising." The Legislature intended this sweeping language to include anything that can properly be called a business practice and that at the same time is forbidden by law. An "unfair" practice is one "whose harm to the victim outweighs its benefits." A practice may be deemed "unfair" even if not specifically proscribed by some other law.

As one court eloquently explained, "given the creative nature of the scheming mind, the Legislature evidently concluded that a less inclusive standard would not be adequate. It would be impossible to draft in advance detailed plans and specifications of all acts and conduct to be prohibited, since unfair or fraudulent business practices may run the gamut of human ingenuity and chicanery." The Act encompasses not only those business practices which have deceived or misled *because* they are untrue, but also those which may be accurate on some level, but will nonetheless tend to mislead or deceive. Thus a perfectly true statement couched in such a manner that it is likely to mislead or deceive the consumer, such as by failure to disclose other relevant information, is actionable under these sections.

As originally passed, the Act allowed any person, company or organization acting for the interests of itself, its members or the general public to bring a claim. In other words, any plaintiff (and his lawyer) could commence a lawsuit asserting the commission of an unfair business practice even though they themselves had not been harmed by the unfair business practice. Although damages would be unavailable, a prevailing plaintiff could obtain an award of attorneys' fees in an action brought on behalf of the general public.

Initially, this was thought to be a good thing. Allowing what has often been referred to as "private attorney general" or "representative" actions in which the prevailing plaintiff's attorney could have his fees paid by the business being sued, made it economically feasible to sue when individual claims were too small to justify the expense of litigation. The award of attorneys fees would, the Legislature hoped, encourage attorneys to undertake meritorious and much needed private enforcement actions. This would protect the public and redress any unfair competition.

An example of the good that can come out of the Act involved an automobile rental company's

*"The Act allowed any person, company or organization acting for the interests of itself, its members or the general public to bring a claim."*

fuel charges. The company purposefully crafted the refueling formulas so that they were incomprehensible and deliberately failed to include the actual price per gallon. The court held that the fact that the fuel charge was authorized by statute did not insulate the company from liability for the confusing and misleading portions of the rental agreement, especially since the confusing provisions of the rental agreement were very different from the much clearer capitalized language in the agreement describing the conduct that would result in a fuel service charge.

In another case also involving rental cars, the contracts allowed the company to charge the "retail value" of the costs to repair cars damaged during rental. The company's practice, however, was to charge customers more than the actual repair costs. Body shops would give the company a discounted "wholesale" price. Instead of passing these savings along to the customers, the company prepared new invoices to reflect a higher retail cost rather than the actual costs. They did not inform customers of this practice or supply customers with an itemized list of the inflated charges. Customers were left with the erroneous impression that the defendants were passing on only the actual repair charges. The court held that the conduct constituted an unfair business practice.

Like many good things, the Act was, unfortunately, subject to abuse. In the opinion of many, it was a boondoggle to unscrupulous attorneys. A notable example involved a law firm that filed 22 lawsuits naming as defendants more than 2,200 auto repair shops and more than 1,000 restaurants and markets. Shortly after filing the suits, the lawyers would send form letters to the businesses, telling them it would cost anywhere from \$6,000 to \$26,000 for a quick settlement. One settlement offer, printed on red paper and obtained by The Associated Press, read: "Either pay even more money to fight in court or settle out of court and get on with business." You may feel better to know that the California Attorney General initiated an investigation against these attorneys using, you guessed it, the Unfair Business Practices Act.

For those not satisfied by this, you should know that on November 2, 2004, the voters approved Proposition 64. Proposition 64 amended the Act to state that an unfair business practices cause of action can only be prosecuted by a person who has suffered injury in fact and has lost money or property as a result of the unfair competition. Further, Proposition 64 requires that a private party may bring a representative action only if he or she could show that the claim could also qualify as a class action. The California Supreme Court recently announced that it will decide whether Proposition 64 should be retroactive.

It remains to be seen whether, through the passage of Proposition 64, voters have thrown the baby out with the bath water.

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## THE AUTOMATIC STAY - A CAUTIONARY TALE

By Michael McQuaid, Esq. and Don Robinson, Esq.

In The Devil's Dictionary, Ambrose Bierce defined litigation as "A machine which you go into as a pig and come out of as a sausage." Although he was not writing about bankruptcy litigation, his words must seem eerily prophetic to the litigants in the bankruptcy case of *Kaufman v. Monte, Polo Investments Fund I, Coast Capital Corp.*, a decision issued recently by the United States Bankruptcy Court for the Northern District of California.

The Bankruptcy Code provides that an automatic stay arises upon the filing of a bankruptcy petition by the debtor. In addition to suspending the commencement or continuation of judicial proceedings against the debtor, the automatic stay at least temporarily prevents any act "to obtain possession of property from the estate," "to create, perfect or enforce any lien against property of the estate", and "to collect ... a claim against the debtor that arose before the commencement of the case." A debtor injured by a willful violation of the automatic stay is entitled to recover actual damages, including costs and attorneys' fees and "in appropriate circumstances, may recover punitive damages." The scope of the automatic stay is extremely broad and, as will be seen, a creditor's indifference to the automatic stay can be extremely costly - in this case the Court entered a judgment totaling in excess of \$1,000,000 against all of the defendants in favor of the debtor.

In February 1999, prior to filing for bankruptcy protection, the debtor was in default on a loan secured by her residence in Orinda. She received a written solicitation from one of the defendants telling her that "with sufficient equity" she could avoid foreclosure with a refinance loan "regardless of credit history, income, or employment." The debtor's application for the loan disclosed that that she was unemployed, had outstanding judgments against her, that she was delinquent on her home mortgage, that she was party to a pending lawsuit, and that she had previously filed a bankruptcy case, which was no longer pending. A new loan, which was secured by the debtor's residence but not by her personal property, was arranged by one defendant and made by another defendant (the "Lender"). The loan immediately went into default. The Lender conducted a foreclosure sale, submitted the high bid at the sale, obtained title to the residence, obtained an unlawful detainer judgment against the debtor, and then evicted her with the assistance of the Contra Costa County Sheriff. Since there was no bankruptcy case pending, none of these actions violated the automatic stay. So far, so good for the defendants.

The loan officer for the defendant arranging the loan was designated to deal with the debtor's

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personal property at her residence. On July 18, 2000, the loan officer arranged for most of the debtor's personal property to be removed from the residence and taken to an auction house. (The court found that the loan officer kept several items for himself.) On July 25, the debtor filed a Chapter 13 bankruptcy case. On August 7, the auctioneer conducted a public lien sale of the debtor's property, allegedly to satisfy storage charges. The sale produced proceeds in excess of the storage costs. The Bankruptcy Court concluded that the defendants kept the excess proceeds to which the debtor was entitled. Numerous boxes of binders and promotional material that the debtor developed for a proposed new business could not be sold and were dumped in the trash.

After the sale, the debtor sued the Lender, the loan officer, and the auctioneer among others for violating the automatic stay. The debtor alleged that she was significantly damaged by the stay violation as her household furnishings were worth over \$1 million (they were sold at auction for approximately \$25,000) and the papers that were thrown out were extremely valuable because they had been developed for her new business. At the conclusion of the trial on the stay violation, the Bankruptcy Court found that the defendants had violated the automatic stay by withholding possession of her personal property from her and arranging for the auctioneer to sell it. The court also concluded that the lien sale violated the automatic stay as it was an act to enforce a storage lien and to recover a claim against the debtor that arose before her bankruptcy filing. While the court agreed with defendants that a lienholder does not violate the automatic stay simply by refusing to return possession to the defendant, it said that retaining possession is a "far cry" from selling the property. The Court characterized as frivolous defendants' argument that they were free to conduct the sale because of the debtor's failure to comply with certain provisions of California law that set time limits for an evicted tenant to regain possession of personal property.

While the defendants asserted that they were unaware of the bankruptcy filing and therefore did not willfully violate the automatic stay, the judge did not believe their testimony - in part because the attorney for some of the defendants filed a request for special notice in the bankruptcy case three days before the auction sale.

The court awarded the debtor in excess of \$100,000 for the actual damages she suffered as a result of the stay violation and also awarded her attorneys' fees. In addition, the Bankruptcy Court awarded punitive damages against the defendants in excess of \$750,000.

What is the lesson that creditors should take away from the case? Although bankruptcy courts are fond of proclaiming that bankruptcy law should not be a trap for the unwary, it is. When in doubt, ask the bankruptcy court for relief from the automatic stay. While it may cost you money you would rather not spend, a mistaken assumption about the applicability of the automatic stay can be ruinously expensive.



## THE PEOPLE AND EVENTS THAT HAVE MADE CARR MCCLELLAN WHAT IT IS AND WHAT IT WILL BE

### PART I - DRAWING STRENGTH FROM OUR PAST (1945 TO 1970)

Carr McClellan was founded in 1945 on one simple principle - provide top quality, sophisticated legal services to the businesses and residents of the San Francisco Peninsula while maintaining the highest ethical standards. Despite sweeping changes to the Peninsula and the continued growth of the firm in number of lawyers and staff, types of services provided, and geographic region served, Carr McClellan continues to thrive by this principle. The firm has been able to maintain this philosophy and its responsiveness to clients' needs based on the solid footing provided by its founders and through the forward looking perspective of the firm's attorneys, both past and present.

60 years ago, the Peninsula was becoming more suburban, with its economy still largely tied to light industry, agriculture and ancillary businesses. There were shipyards in South San Francisco and the main terminal at SFO had yet to be built. The existing communities along the El Camino Real corridor, including Burlingame, Hillsborough and San Mateo were small, and suburbanization was just beginning to take hold, converting the open spaces of the grand, 19th century country home estates into subdivisions and commercial properties.

Luther Carr, who had been working as a district attorney in Jasper County, Iowa, relocated to Burlingame in 1943 and worked at the Office of Price Administration for the remaining two years of World War II before deciding to go into private practice. After meeting with the two leading attorneys practicing in Burlingame at the time, Carl Anderson and Ed Cosgriff, he decided to join with native San Franciscan Cosgriff and in September 1945 established the law firm of Cosgriff and Carr. Their first space was in Cosgriff's existing offices above Miller's Drugstore on Burlingame Avenue at the corner of Lorton Road.

J. Ed McClellan, Jed to everyone who knew him well, had moved to Burlingame in the late 1920s but practiced law in San Francisco. He attended the preorganization dinner of the State Bar of California in 1927, a time when the community of attorneys in California was much smaller, as his bar number, 276, reflects. Severely injured in World War I, McClellan was beginning to see his health deteriorate when his doctor recommended he move his practice closer to his home. McClellan joined Cosgriff and Carr in September 1946 and in December of that year Cosgriff, Carr & McClellan moved its offices into a location a block away. This new building was among the first in Burlingame to have a passenger elevator.

What was to become one of the firm's hallmarks was established at the outset - a dedication to civic and charitable institutions. Cosgriff had already served as Burlingame Chamber

President, an office that would be held by a succession of Carr McClellan attorneys. He also worked with the American Red Cross, Boy Scouts of America and the Traffic Committee of San Mateo County. (Apparently, by 1945 traffic was already an issue for the region.) Carr and McClellan were just as active, taking leadership roles in Community Chest Drives, the Red Cross, YMCA and other organizations, and the firm quickly gained a reputation for its community service.

According to a Dec. 12, 1946 article in *The Burlingame Advance-Star*, "The extra-curricular activities of the firm's members have made it almost a public institution."

Within a year of McClellan's joining the firm, Cosgriff, who was in his mid 60s, was diagnosed with cancer. Faced with his own mortality, he told his partners that they should find another attorney to join the practice.



The space above Miller Drug Co. in Burlingame would become the firm's first offices in 1945.

"When they sat down to discuss it, each of them already had someone in mind," notes Albert Horn, Chairman Emeritus of the firm and former Managing Partner. "All three of them, without having talked about it before, thought of one person - Frank Ingersoll."

Ingersoll had been practicing at a San Mateo firm when in July 1947 he joined with the other three attorneys to form Cosgriff, Carr, McClellan and Ingersoll. A short time later, Cosgriff passed away.

After Cosgriff's death, the three remaining partners had what was at that time a revolutionary idea - they should own their own building.

"Most law firms of the 1940s were small and virtually all of them rented their office space. For a law firm to build and own its space was virtually unheard of," says Horn.

In 1949, the firm moved into its new office building at Carr McClellan's current location at 216 Park Road, and while the address has remained the same little else of the original building has. Like the firm itself and the surrounding community, Carr McClellan's office building would undergo dramatic changes throughout the next half century, growing from a one-story, 5,000-sq.-ft. structure to a three-story, 38,000-sq.-ft. office complex.

1949 also saw the addition of Bob Thompson to the firm. Thompson, like Ingersoll, was a World War II veteran, and he had taken part in the Normandy landing on D-Day. He joined the firm straight out of Stanford Law School and, according to Horn, served as a "utility infielder" as a young associate, primarily working with Carr and Ingersoll.

San Mateo County witnessed tremendous growth in the 1950s. The open space between northern Burlingame and

Millbrae Avenue, which had been part of the Mills Estate, was developed into housing. The airport expanded and became a catalyst for new business development in the northern part of the county, and Stanford University was having a similar effect in the southern part of the Peninsula, serving as an incubator for technology start up talent.

Carr McClellan was working with many of the new businesses and public institutions that were developing to serve a growing population. In the late 1940s and early 1950s, the firm was integral to the formation of the Peninsula Hospital District. In fact, for some time the only meeting space the district board had was Carr McClellan's conference room. The firm helped shepherd the organization through the opening of Peninsula Hospital in 1954, and the relationship between the firm and hospital continued, playing an important role in the structural changes to health care that would take place through the decades that followed.

By the latter part of the 1950s, the attorneys' legal specialties would become more sharply defined and in so doing, the firm's founders began to lay the foundation for Carr McClellan's existing practice groups. While Carr, McClellan, Ingersoll and Thompson each would continue to provide a broad range of legal services throughout their careers, they had become known individually for specific expertise.

Carr had gained a reputation for his litigation skills, McClellan for his knowledge of estate and trusts planning, Ingersoll for his ability in corporate transactions and Thompson for his real estate prowess. These four primary practice areas would continue to expand and develop in response to the changing needs of the firm's clientele into the 11 practice groups the firm has today.



*Through the past 60 years, Carr McClellan has grown to occupy this 38,000-sq.-ft. office complex on Park Road.*

The addition of Albert Horn to the firm in 1952 signaled the beginning of what would become Carr McClellan's prominent Estate Planning, Trusts & Wealth Transfer Group. Horn was finishing his clerkship with Justice Spence at the California Supreme Court when he was contacted by Jed McClellan.

"We met for a short time and immediately found a rapport," recalls Horn. "He was a lawyer's lawyer and we shared a common outlook on what it meant to be a truly outstanding attorney."

Like the other four attorneys at the firm, Horn developed a general practice, but he spent the majority of his time working with McClellan on estate planning matters and Ingersoll on corporate matters. One of his first clients was real estate developer Charlie White who Horn represented in the

conversion of Sneath Dairy Farm in San Bruno into a residential subdivision.

"Charlie was a wonderful client and instrumental in the early stages of my career," says Horn. "We were able to work on many projects, and he was very generous in recommending me to his business contacts." Horn maintained that relationship until White's untimely death on Christmas Eve 1960, when the plane he was piloting crashed near Moffet Field.

A memo written by Horn to McClellan in the mid 1950s set him on the course of firm leadership, although he did not know it at the time. Horn recognized deficiencies in the firm's accounting system and client cost accounting system and his memo suggested an overhaul of both. He received no immediate reply and after several weeks thought his memo had been ignored. However, at a meeting of the attorneys he was singled out as the attorney with an interest in managing the office and named Office Manager.

Carr McClellan continued to grow and by the late 1950s had eight attorneys and not enough office space. 216 Park had already been remodeled twice but it was about to begin a series of major transformations that would eventually see the firm's offices expand into the neighboring lot, take over the corner gas station and go up two floors.

The firm's reputation for handling complex transactions was also on the rise. As a party to one of the largest real estate projects in San Mateo history - the development of Foster City, the firm represented the owners in the sale or lease of property to residential and commercial developers. In addition to handling the transactions the attorneys dealt with riparian rights to the canals that define Foster City and decades later would represent the owners in protecting their leased interests.

As Foster City was being built, Carr McClellan's offices continued to be rebuilt. During a 1966 remodel, some attorneys and staff were temporarily relocated to a trailer in a neighboring parking lot. The close quarters and lax cigarette policies of the time made for a smoky situation that Horn was forced to extinguish through a carefully worded memo that began "Dear Trailerites."

This expansion in square footage was not just a reflection of the increase in the number of attorneys but also the growth in the type and complexity of the firm's practice areas. In 1968 the firm closed its largest business transaction to date when it represented Gamlen Chemical Company in its multi-million dollar sale. Through the representation of Ames Taping Tools, Inc. in its sale, the firm was introduced to a member of the Kinney family, and a relationship was established that continues to this day. For another client from that time, Edward Scripps, the firm first developed his estate plan then expanded this relationship, representing him and the Scripps Company on a variety of business matters as the publishing empire underwent significant changes. This expansion of a client relationship into business, real estate and other areas based on the initial development of an estate plan would become a pattern for Carr McClellan. It seemed that with almost every engagement a door was opened to a new opportunity.

By 1970, Luther Carr and Jed McClellan had retired and the leadership of the firm had transitioned to the next generation of attorneys, represented by Bob Thompson and Albert Horn. San Mateo County had through the previous two decades transformed itself and Carr McClellan was adapting right along with it.

TO BE CONTINUED...





# SPECIAL PURPOSE ENTITIES FOR REAL ESTATE LOANS: BURDENSOME LENDER REQUIREMENTS CAN PAY OFF IN ADDITIONAL CASH FLOW

By Matthew Love, Esq.

You identified your next real estate investment and you have the property under contract; your next focus is financing. Whether you are obtaining new financing or assuming an existing loan, a common source of funding is a Commercial Mortgage-Backed Securities (CMBS) loan.

A CMBS loan is a form of debt that gets bundled with other similar loans into portfolios, which are then sold to investors in the form of Commercial Mortgage-Backed Securities. These loans are also referred to as conduit loans because the lender is essentially only a conduit or middleman, funneling the loan funds between real estate investors and CMBS investors. CMBS loans generally provide lower interest rates and are amortized over longer periods than standard bank loans. But because these loans get bundled into securities portfolios, they have more complex underwriting requirements, which result in higher associated fees and costs. One significant condition of most, if not all, CMBS financing is the requirement that the borrower own and operate the mortgaged property under a Special Purpose Entity.

## I. What is a Special Purpose Entity (SPE)?

An SPE is a legal entity (typically a limited liability company) usually formed immediately prior to the purchase that does nothing but hold title to and operate the mortgaged property. The SPE is managed and owned by the real estate investor but the structure of the SPE keeps the mortgaged property legally separated from the investor's other business ventures and insulated from other creditors.

## II. Creating the SPE

The SPE entity most often used in real estate transactions is a limited liability company (LLC). How and where you create your LLC usually will be dictated by the lender. During the underwriting process, the lender will provide a laundry-list of provisions that will need to be included in the SPE's operating agreement. These required provisions will vary from lender to lender but usually become more onerous the larger the loan.

There are a few requirements that will almost always be present: (i) the SPE's purpose will be limited solely to owning and operating the mortgaged property,

*“Because of the lender’s legal opinion requirements, the investor may have to foot the bill for three law firms.”*

(ii) the SPE will be prohibited from engaging in an insolvency proceeding, dissolution, liquidation, merger, or transfer or sale of assets except under limited circumstances, and (iii) the SPE will be required to maintain its separateness by maintaining its own books and accounts, not commingling funds, operating under its own name, and observing all LLC formalities.

Some lenders will also dictate where you form your LLC. Certain lenders will require a Delaware LLC because Delaware has laws favoring creditors. If the lender does not have a specific requirement, then the LLC would typically be formed in the state where the investment property is located.

## III. SPE Requirements and Legal Opinions

It may sound like a primer for a bad lawyer joke, but just how many law firms does it take to close a transaction? Many investors are surprised to learn that, because of the lender's legal opinion requirements, the investor may have to foot the bill for three law firms: (i) the investor's primary firm, (ii) a firm in the state where the property is located, and (iii) a Delaware firm.

Why three law firms? The investor's primary firm will be directing and coordinating the overall transaction and the closing. In addition, the primary firm will usually need to issue a legal opinion that the loan documents are duly executed and delivered by the investor and that the LLC is free from litigation and adverse administrative proceedings.

Next the lender will want a legal opinion from a firm located in the state where the investment property is located. There the lender will want confirmation that the various transaction documents are enforceable in that state.

Last, if the LLC is a Delaware LLC, the lender will want an opinion from Delaware counsel that the LLC is duly organized, and sometimes an opinion that the LLC is bankruptcy-remote. Through a bankruptcy-remote legal opinion, the lender is seeking reassurance that, if a principal of the LLC became insolvent, the assets of the LLC would not be consolidated into the insolvency of the principal. This bankruptcy-remoteness protects the lender's security (i.e., the mortgaged property) from the principal's other creditors and is essentially the driving force behind the Special Purpose Entity requirement.

## IV. What Does All this Really Mean?

A CMBS loan is an excellent vehicle for a long-term, low interest real estate loan. But because of the requirements of Special Purpose Entities, the time and costs involved are not insubstantial-in some instances creating \$10,000 or more of added legal fees.

So be prepared to jump through some hoops. And be prepared to incur greater costs in the initial transaction. But also be prepared to recoup those costs and take advantage of the additional cash flow that your investment will generate as a result of carrying a low interest CMBS note.



estate and GST taxes under the 2001 Act, the current transfer tax system will be replaced by an equally perplexing and likely more complicated transfer tax system. How are you to embark on a plan of gifting or plan your estate in this tangled mess of a transfer tax system? A close look at our current transfer tax system and the effects of the anticipated repeal or compromise hopefully will shed some light on the issue.

**The 2001 Act**

Under the 2001 Act, determining the amount of federal estate and GST taxes that would be charged on a decedent's estate or on a generation-skipping transfer (e.g. a gift to your grandchild) can sometimes require a crystal ball. The amount that you can transfer in a generation-skipping transfer or that you can have in your estate at your death without incurring a federal estate tax or GST tax changes periodically until 2009, when each of these exemption amounts reaches \$3,500,000 per person. At the same time, federal tax rates on any taxable estate or GST will decrease annually, leveling off at 45% in 2007. Interestingly, during this same timeframe the cumulative amount each person can transfer *by gift* without incurring any *federal gift tax* will remain steady at the current level of \$1,000,000 (the "federal gift tax exemption amount").

In 2010, the federal estate and GST taxes are scheduled to be repealed, but the federal gift tax will continue in effect. In 2011, the federal estate and GST taxes will re-emerge, with each person having a \$1,000,000 federal estate tax exemption, a separate \$1,000,000 federal GST tax exemption and the still effective \$1,000,000 federal gift tax exemption. Determining how much federal estate will be charged on your taxable estate or the amount of GST taxes you will incur on a gift you make or on your estate at the time of your death will depend almost entirely on the year in which the gift is made or the year in which you die.

In conjunction with the dramatic changes to the federal estate and GST taxes, the laws concerning the income tax basis of property received as part of an inheritance change radically depending on the year of the decedent's death as part of the 2001 Act. Currently, each asset in a decedent's estate receives a new "stepped-up basis" for income tax purposes equal to the fair market value of the asset as of the decedent's date of death. Then, in 2010 the "stepped-up basis" regime will be replaced by a "carry-over basis" regime under which the assets of a decedent's estate will be transferred to the decedent's heirs at the decedent's basis, not at the date-of-death-value "stepped-up basis." Fortunately, the personal representative of a decedent's estate will be able to allocate \$3,000,000 of "basis increase" to assets passing to the decedent's surviving spouse, and an additional \$1,300,000 of "basis increase" to assets passing to anyone from the decedent's estate. As you can well imagine, the complexities involved in the "carry-over basis" regime will not be insubstantial, including (1) the difficulties in determining the basis of each asset in

*"Keep in mind that even with complete repeal of the federal estate and GST taxes in 2010, three different types of taxes may still apply to your estate planning transactions."*

a decedent's estate (including such items as jewelry, furniture, and personal effects, and securities held in dividend reinvestment accounts), and (2) the potential conflicts of interest faced by the personal representative of a decedent's estate in determining which assets are to receive the benefit of the "basis increase." In 2011, the "stepped-up basis" regime will once again apply to assets in a decedent's estate, but the "carry-over basis" regime will continue to apply in the federal gift tax arena. Confused? Wait, there's more.

Keep in mind that even with complete repeal of the federal estate and GST taxes in 2010, three different types of taxes may still apply to your estate planning transactions. First, the *federal gift tax* will continue to exist, with the current \$1,000,000 federal gift tax exemption amount and a tax rate of 35% on cumulative gifts in excess of the exemption amount. Second, the carry-over basis regime will apply to assets acquired as gifts or as part of an inheritance. Third, the repeal of the *federal* estate and GST taxes does not guarantee that the assets in your estate will not be subject to such taxes at the *state* level. In certain states (*not* California), a state estate or inheritance tax and, possibly, a GST tax will continue to be imposed on the assets of a decedent that are *located* (e.g. real property) within that state, even if the decedent does not live in that state.

The complexities of the existing transfer tax system can best be illustrated as follows: John Smith dies in 2009 owning a house that he purchased in 1975 for \$100,000, and cash of \$200,000. Immediately prior to his death, the house has a basis of \$100,000 and a fair market value of \$2,500,000. There would be no federal estate tax due on John Smith's estate (assuming for the sake of this example that he had no other assets at the time of his death), since the federal estate tax exemption amount in 2009 will be \$3,500,000 and his total estate is valued at \$2,700,000. As a result of his death, the new basis of the house is \$2,500,000. Therefore, if his heirs soon sold the house (before it appreciated in value), there would be no capital gains on the sale. If John instead made a gift of his home in 2009, John would have to pay federal gift tax on \$1,500,000 (the value of the gift in excess of the federal gift tax exemption amount), and his donees would have a basis of \$100,000 in the property, resulting in a capital gain of \$2,400,000 if they were to sell the property. If John dies in 2010 there would be no federal estate tax on John's estate as a result of the federal estate tax repeal under the 2001 Act. Assuming John is not survived by a widow, the executor of his estate could allocate \$1,300,000 of basis increase to John's house to increase the basis of the house from \$100,000 to \$1,400,000. Consequently, if his heirs sell the house for \$2,500,000, they would have a capital gain of \$1,100,000 that would be subject to income taxation. And while there may be no federal estate or GST tax on the assets in John's estate, there may be state estate or inheritance

see ESTATE PLANNING, *page 8*



taxes. If John Smith does not die in 2010 but instead makes a gift of his house in 2010, John will have to pay federal gift tax at a rate of 35% on the value of the house in excess of \$1,000,000. If John's donees sell the house, there will be capital gains of \$2,400,000 (the difference between the sale price of the house and John's basis in the house).

As you can see from the above examples, the future as it applies to the transfer tax system is fraught with traps for the unwary, with many tax pitfalls that must be carefully avoided in making gifts or planning your estate. The current ideas being discussed by the Congress (e.g. making permanent the provisions of the 2001 Act that are scheduled to go into place in 2010, or enacting a compromise) will provide some much needed certainty on the issues, but will not eliminate the various transfer tax traps awaiting the unwary.

#### Planning for the Uncertain Future

How best, then, to avoid those traps?

First, if your desire is to make gifts during your lifetime, you should consider the following: If you do not want to incur any federal gift tax on your gifts, there is no reason to postpone a plan of gifting *provided* that your cumulative gifts do not exceed the \$1,000,000 federal gift tax exemption amount. There seems to be relative stability in the federal gift tax law other than a reduced gift tax rate in 2010. So long as your cumulative gifts do not exceed \$1,000,000 in value, the repeal of the federal estate and GST tax under the 2001 Act would have little impact on those gifts. Furthermore, a compromise by Congress that would increase the federal estate and GST tax exemption amounts and/or reduce the federal estate and GST tax rates would not adversely affect those gifts. Therefore, there is little risk in making current lifetime gifts within the federal gift tax exemption amount of \$1,000,000.

If you decide that you want to make gifts during your lifetime, you may want to consider one of the many estate planning techniques that can leverage your gifts, thereby enabling you to transfer more to your beneficiaries without incurring gift tax. The current low interest rates make several techniques quite attractive, including grantor retained annuity trusts or unitrusts, charitable lead trusts and sales to grantor trusts. You may wish to discuss these techniques with your estate planning attorney to determine which of them might be right for you.

If you anticipate that your gifts will exceed the \$1,000,000 federal gift tax exemption amount, even when leveraged through one of the above estate planning techniques, the decision on whether to postpone those gifts should be made only after weighing several factors.

Analyze the potential benefits of making the gifts currently, such as being able to transfer assets to your descendants at a low value when those assets are expected to appreciate greatly in the near future, or participating in a gifting transaction that increases the income tax basis of highly appreciated assets, or reducing the

value of your taxable estate for federal estate tax purposes by the amount of the gift and, perhaps, the amount of the gift taxes paid on the gift. Then determine whether you are comfortable in making an irrevocable transfer of your property if there is not a sufficient non-tax-related reason to do so. Lastly, consider the risk you may run of paying a higher tax rate on immediate gifts than you might pay if the tax rate on gifts drops, like it is scheduled to do in 2010. If the benefits of making a current taxable gift outweigh the detriments, then proceed with making your gifts. Of course, if tax avoidance is not high on your list of concerns in making the gifts, and postponing the gifts might not accomplish your goals, by all means, *proceed with your plan of gifting*.

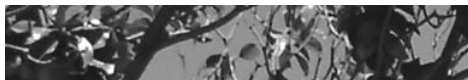
Second, with respect to planning your estate, if you have no estate plan, *proceed with planning your estate*. One of the best legacies you can leave to your family upon your death is an estate that is organized, well thought out and planned, and that requires little effort to administer or distribute. You don't want to add any unnecessary burden to your spouse or children at a time when they are trying to cope with your loss.

If you have an existing estate plan, you should review the terms of your existing estate planning documents periodically to ensure that your estate plan still accomplishes what you intended it to do. If it does not, you should have it revised now. Although Mr. Franklin was correct in stating that death is one of the certainties in this world, the *timing* of each of our deaths is not, so plan now lest you are unable to plan later. The key aspect of any estate plan, whether it currently exists or whether it is one you seek to implement, should be *flexibility* – flexibility to take into account the tremendous uncertainty in the transfer tax laws and to enable you to accomplish your goals.

Third, in order to avoid income tax nightmares in the future, keep accurate records of the income tax basis of all of your property. This information is absolutely necessary in the carry-over basis regime that exists in the federal gift tax area and that will be applied to inherited assets in the case of federal estate tax repeal under the 2001 Act. The failure to keep these records may result in unnecessary income taxation upon the sale of gifted or inherited property. Remember, this income tax will be borne by the *recipients* of the property, not you.

Finally, no matter what you decide to do with your estate, make certain that your estate plan continues to accomplish your goals throughout these uncertain times.

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