

Estate Planning in 2009

Has the “Shelf Life” of Your Estate Plan Expired?

Amid all the economic turmoil in recent months, it’s easy to overlook some very **good news** about estate taxes. Many individuals who have worried about the impact of estate taxes on the inheritance of their children need worry no longer. The increase in the federal estate tax exemption to **\$3,500,000** effective January 1, 2009 means that many single persons and married couples no longer need to incorporate estate tax planning into their wills and revocable trusts. Because of the recent decline in the value of investment assets, the estates of some clients have dropped below the \$3,500,000 threshold, and the tax planning provisions in their estate plans are no longer beneficial.

For clients who still have taxable estates, this is an opportune time to consider gifting while interest rates and market values are down and before some beneficial planning techniques are repealed by new legislation.

How Far We’ve Come

Let’s review the changes in the federal estate tax exemption and the top estate tax rates since the enactment of the Bush tax cuts in 2001:

Year	Exemption	Top Tax Rate
2001	\$ 675,000	55%
2002	\$1,000,000	50%
2003	\$1,000,000	49%
2004	\$1,500,000	48%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007	\$2,000,000	45%
2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010 and future (expected)	\$3,500,000	45%

The \$3,500,000 exemption now in effect represents more than a **5-fold** increase from the \$675,000 exemption in 2001. It is safe to say that most Americans are now free from the threat of confiscatory estate tax at death. Virginia residents enjoy the added relief of the repeal of a separate Virginia estate tax in 2007.

The GST exemption for generation-skipping transfer taxes also increased to \$3,500,000 in lockstep with the estate tax exemption. That's great news for families who wish to protect wealth from taxation and outside creditors for the eventual benefit of grandchildren or later generations through the use of trusts.

The lifetime gift tax exemption remains stuck at \$1,000,000. Consequently, substantially more wealth can pass tax-free at death than by lifetime gifts.

The gift tax annual exclusion also increased from \$12,000 to \$13,000. With proper planning, a married couple may now gift up to \$26,000 per child or grandchild each year without using any portion of the gift tax exemption or estate tax exemption.

What's Next?

The Obama administration has proposed making the \$3,500,000 estate tax exemption and the 45% tax rate permanent, and there seems to be enough support in Congress to enact that legislation. Prospects for permanent estate tax repeal have been dim for many years, and are now completely dead. But the good news is that there does not appear to be any effort to roll back the estate tax exemption to some amount less than \$3,500,000. Estate planners can make recommendations with relative confidence that the \$3,500,000 exemption will remain in effect for the foreseeable future.

Other estate tax "reforms" are looming on the horizon, however. Few of these are good news for individuals or couples whose estates are large enough to remain subject to estate tax. Some of the proposals under discussion include:

- Elimination of valuation discounts for family-owned limited liability companies (LLCs) and family limited partnerships (FLPs).
- Elimination of leveraged gifts using Qualified Personal Residence Trusts (QPRTs) and Grantor Retained Annuity Trusts (GRATs).
- Restrictions on "Crummey" withdrawals rights for the gift tax annual exclusion.

Problems With Existing Estate Plans

Many estate plans implemented in previous years were designed to minimize or eliminate estate taxes. The estate plan for a married couple typically includes the creation of a Family Trust at the death of the first spouse in order to utilize the estate tax exemption of both spouses. Except in community property states like California, this planning requires the husband and wife to keep their financial assets separately owned. The Family Trust technique is still important if the value of the couple's combined estates (including the face value of life insurance policies) may exceed \$3,500,000.

If the married couple's total assets are under \$3,500,000 and likely to remain so, the Family Trust no longer serves any tax purpose. The couple is free to restore joint ownership of their assets, leave everything to each other in a simple will, or utilize a joint revocable trust to keep investment assets outside probate at the death of either spouse.

Failure to update an estate plan before the death of the first spouse can be a significant financial detriment to the surviving spouse. The settlement of the first spouse's estate is complicated by the required funding of the Family Trust, thereby increasing estate expenses. Often the surviving spouse is not the sole beneficiary of the Family Trust and may have to share distributions with other beneficiaries. The legal, accounting, investment and income tax requirements for the proper administration of the Family Trust during the lifetime of the surviving spouse can be burdensome and expensive. The only option available to the surviving spouse to avoid the creation of the Family Trust is a complete "disclaimer" of his or her interests in the trust, thereby accelerating the distribution of the trust assets to the children. Few spouses are willing to forfeit the income and "safety net" benefits of the Family Trust in order to avoid those administrative burdens and expenses.

However, there are non-tax advantages of the Family Trust that may justify retaining it in the estate plan. These include:

- *Retention of wealth in the family.* If one spouse owns inherited assets, he or she may feel a stewardship duty to keep those assets in the family. The potential remarriage of the surviving spouse might also be a concern. The Family Trust may provide that only children and descendants of the current marriage receive the assets when the surviving spouse dies.
- *Fairness in blended families.* If either or both spouses have children by a previous marriage, a Family Trust is often recommended whether or not there is any estate tax benefit. The Family Trust assures the children of the deceased spouse that their eventual inheritance is secure.
- *Spendthrift or creditor protection.* The surviving spouse may lack the skills, experience or temperament to wisely invest and administer financial assets. In other cases the surviving spouse may have exposure to potential creditors. The use of a Family Trust with an independent trustee is a common "asset protection" technique to preserve family wealth.

Many estate plans determine the value of the Family Trust by reference to the estate tax exemption. The dramatic increase in the exemption may skew the intended division of estate assets at the death of the first spouse. The Family Trust may receive more than anticipated when the estate plan was prepared, leaving an insufficient amount for the surviving spouse.

A related problem can occur if the estate plan provides that assets in excess of the exemption amount are added to a Marital Trust rather than pass outright to the spouse. The reduced value of the Marital Trust may be insufficient to justify the administrative burdens and expenses of this lifetime trust for the spouse's benefit.

Some tax formulas utilize the GST exemption to determine what portion of the children's inheritance passes to them outright, and what portion is held in lifetime, generation-skipping trusts for their benefit. The increase in the GST exemption to \$3,500,000 significantly reduces, and perhaps eliminates, the children's outright inheritance.

Short Term Planning Opportunities

For estates well in excess of the \$3,500,000 estate tax exemption, there may be opportunities to take advantage of existing techniques before new legislation is enacted.

- GRATs are especially effective in "leveraging" lifetime gifts to children with minimal tax consequence when prevailing interest rates are low.
- Gifts of minority interests in family businesses, LLCs and FLPs should be considered while valuation discounts are still permitted.
- Annual exclusion gifts that rely on Crummey withdrawal rights might be accelerated this year.
- Because real estate values are low, transferring a personal residence to a QPRT can avoid estate tax on much of the residence's current value and on all future appreciation.
- Although not targeted for elimination, a Charitable Lead Annuity Trust (CLAT) is exceptionally well suited in the present economic environment for individuals who may be inclined to make annual charitable gifts and want to shift wealth to the children without tax.

Summary

2009 is not a year to "wait and see" for estate planning. Many existing estate plans are beyond their shelf life expiration date. And tax saving opportunities are available now that might be repealed before the end of the year.

Every estate plan is dynamic and requires revision and updating as the law and personal circumstances change. An outdated plan can sometimes be worse than no plan at all. Bottom line: the only good estate plan is an up-to-date plan.