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Estate Planning Advisory

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While we are experiencing unprecedented challenges in our economy and politics, these circumstances and other developments over the last few years present historic opportunities and pitfalls for everyone's estate plan.

FEDERAL ESTATE TAX WILL CHANGE AGAIN SOON

Way back in 2001, the federal government put us on a track that over this decade has increased the exemption from estate tax upon death (reduced by lifetime taxable gifts beyond any annual exclusion gifts) from $1,000,000 to $3,500,000 per decedent and has reduced the maximum estate tax rate from 55% to 45%.

The exemption increase may have unexpected consequences for some. For example, for married couples, under many existing estate plans, the exemption increase may shift assets that otherwise would have gone to the marital share for the benefit of the surviving spouse instead to the family share, where they mayor may not be held for the benefit of the surviving spouse and other family members. Married couples should review this development for acceptability under the current $3,500,000 estate tax exemption.

The proponents of federal estate tax repeal from the early part of this decade had hoped to have achieved permanent repeal by now. Their efforts ultimately failed and, under the law as written today, the federal estate tax will be repealed for only 2010. Then in 2011, the 2001 law will be reinstated dropping the estate tax exemption back down to only $1,000,000, increasing the maximum estate tax rate back up to 55%, and reinstating certain other features. Nonetheless, we think it highly unlikely that either of the 2010 or 2011 scheduled changes will be allowed to take effect.

President Obama has opposed any repeal of the estate tax and instead has proposed making permanent the $3,500,000 estate tax exemption and 45% maximum federal estate tax rate. Some in Congress also are interested in indexing the estate tax exemption for inflation. At this juncture, we expect that Congress either will follow his lead or at least will amend the federal estate tax so that the scheduled 2010 one-year-repeal will not take effect, which at worst they could do by canceling the 2010 repeal and accelerating the return to the 2001 law to take effect in 2010.

There are proponents of making the estate tax exemption "portable" between spouses. That would mean that if one spouse died with an estate worth less than the estate tax exemption amount, the survivor could add that shortfall to her exemption to shield more of her estate from estate tax.

LIFETIME GIFTING WITH DEPRESSED VALUE ASSETS IS SILVER LINING TO DARK ECONOMIC CLOUDS

If properly structured, gifts of assets during life and appreciation in their value through the date of death can avoid estate tax entirely, and potentially gift tax too. The gift tax law encourages limited lifetime gifting. Each calendar year, an individual can give away up to $13,000 to as many individuals as she wishes. This is known as the "annual exclusion" from gift tax. Such gifts are usually best made early in the year so that subsequent appreciation also can be excluded and to avoid loss of the exclusion altogether if the donor were to die during the year before making annual exclusion gifts. Beyond that, under current law each individual can make nontaxable lifetime gifts to nonspouses totaling up to $1,000,000. As noted above, to the extent that gift tax exemption is used during life it reduces the $3,500,000 estate tax exemption. A silver lining of the dark economic clouds currently over head is that properly structured gifts of assets with currently depressed values are more effective than later gifts of those same assets once their values have recovered to more normal levels. That makes right now an ideal time to make gifts for estate planning purposes. Additional lifetime gifting will be encouraged if the gift tax exemption is increased to $3.5 million to match what many anticipate will become the increased estate tax exemption.

LOW INTEREST RATES PRESENT ESTATE PLANNING OPPORTUNITIES

The current low interest rate environment also creates many opportunities to transfer wealth to junior generations at lower gift tax costs than previously. These opportunities exist because investment returns over time are likely to exceed the interest rate the IRS requires to be used in determining gift tax consequences. Some of these opportunities permitted under current law may be curtailed in the not too distant future, either as a trade off for broader estate and gift tax reform, or otherwise due to taxing authorities' concerns that they are too generous. Included among those opportunities are those provided through the use of intra-family loans, grantor retained annuity trusts ("GRATs"), intentionally defective irrevocable trusts ("IDITs"), and charitable lead annuity trusts ("CLATs"). Accordingly, individuals interested in making significant lifetime gifts should evaluate the suitability of these opportunities for their estate plans.

BENEFITS OF FAMILY LIMITED PARTNERSHIPS MAY BE CURTAILED BY NEW ADMINISTRATION

In 1993 the Internal Revenue Service gave up its fight against certain planning opportunities using family controlled entities. Since then, many families have structured the transmission of their nonpersonal business and investment wealth through family limited partnerships or similar entities that provide significant opportunities for asset management, wealth transmission to junior generations, and the potential for significant (25% to 45%) entity related discounts for estate and gift tax purposes. During the 1990s the former Clinton administration's Treasury Department proposed changes in the law that would have reduced or eliminated the availability of those discounts, but that proposal never became law because it was blocked by the then Republican controlled Congress. Now that both the executive and legislative branches are controlled by Democrats, there is concern that the discounts available through the use of those types of entities again might be at risk. Nonetheless, those discount opportunities still exist at this time and may be granted "grandfather" status if implemented soon before the prospective law changes are passed.

FLORIDA TRUST CODE CHANGES MAY AFFECT TRUSTS IN YOUR ESTATE PLAN

Florida updated its trust code applicable to all Florida trusts effective July 1, 2007, and many of those updates apply to trusts created before that date, although most of the retroactively applied changes are not problematic. Accordingly, if your estate plan includes a trust created before then or one that will be created under your estate planning documents executed before then, we encourage you to meet with us to determine the implications of the new trust code for your estate plan.

DURABLE POWERS OF ATTORNEY AND ADVANCE DIRECTIVES NEED UPDATING FROM TIME TO TIME

The laws applicable to durable powers of attorney and advance directives (health care surrogate designations, declaration of preneed guardians, and living wills) change from time to time. In particular, if your durable power of attorney and advanced directives do not include provisions addressing the effect of the privacy rules under the Health Insurance Portability and Accountability Act, also known as "HIP AA," we encourage you to contact us to arrange to have those documents updated. Without the necessary HIP AA provisions, your appointees, such as your health care surrogate, may not be allowed access to relevant information to carry out their duties.

ASSET PROTECTION IS NOW FOR EVERYONE

A dozen or so years ago, most of our asset protection work for clients focused on the needs of individuals in professions with substantial malpractice claim exposure, such as physicians. Today, one need only note the many billboards and television advertisements inviting the allegedly injured and aggrieved to sue for damages. As part of our routine estate planning work, we consider the exposure of our clients' assets to claims of all sorts of creditors, whether they might arise from negligence claims, personal or business debts, and beyond. Today's strained economic situation makes an evaluation of those risks all the more important for everyone.

CIRCULAR 230 NOTICE

To comply with US. Treasury Department and IRS regulations, we are required to notify you that, unless expressly stated otherwise, any US. federal tax advice contained in this memorandum is not intended or written to be used, and cannot be used, by any person for the purpose of (i) avoiding penalties under the US. Internal Revenue Code, or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed in this memorandum. This memorandum provides information in a non-technical manner and is not intended to be a legal or tax opinion.

Trusts & Estates Group

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