

LEGAL ALERT

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NEW YEAR ESTATE PLANNING & PREDICTIONS

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With a dismal economy and a change in political administrations, no one's crystal ball can clearly show the future as it relates to estate planning. However, some things are fairly safe to predict.

1. Estate Taxes. The Obama campaign promised to "freeze" the federal estate tax exemption amount, a/k/a the *applicable exclusion amount*, at \$3.5 million per taxpayer. It also promised to leave the current federal estate tax rate at a flat 45%. The question is whether those rules, which arrive in 2009, will be made permanent, will only be temporary, or whether other changes are in store to increase revenues. ***A \$3.5 million estate tax exemption per taxpayer is a safe bet for the foreseeable future.***

2. Gift Taxes. ***The federal gift tax lifetime exemption amount will remain at \$1 million per taxpayer.*** This exemption is tied to the estate tax exemption; if \$1 million is gifted "gift tax-free" during your lifetime, only \$2.5 million of your estate can be transmitted estate tax-free at the time of your death.

3. Annual Exclusion. ***The federal gift tax annual exclusion will increase in 2009 to \$13,000 per donee for "present interest" gifts.*** That means that the gift must be made directly to the donee, and not in trust, nor with a delayed distribution to the donee.

4. Unlimited Gifts. ***Gift tax-free unlimited direct gifts for tuition and health care are still available.***

How does the economy and the dramatic loss of wealth that occurred over the past 16 months impact your estate planning? Some thoughts come to mind that you may want to consider while asset values and interest rates remain down.

1. Revisit Your Existing Trust. You should first take a look at your old estate planning Trust if it was created long ago when the federal estate tax exemption was dramatically lower. Most Trust's formulae direct the Trustee to transfer to a Credit Shelter Trust (also called a Bypass or Family Trust) the amount which can be transferred without any federal estate tax imposition. Only the excess is transferred either outright to the surviving spouse or to a Marital Trust for the survivor's benefit. If your estate has been cut in half with the drop in the stock market, and at the same time the applicable exemption amount now is at \$3.5 million, there is a pretty good chance that all of your assets will flow to the Credit Shelter Trust and no assets will be transferred to the Marital Trust, or outright to your surviving spouse. This formula must be re-examined because many times the Credit Shelter Trust provides that the Trustee distributes trust income or principal to the surviving spouse based only upon the survivor's need. Restated, the surviving spouse may not have any "rights" to either the income or the principal held in the Credit Shelter Trust. If that is where all of your assets are going to be "bunched" it makes sense to take a second look at the terms of the Credit Shelter Trust to ensure that those terms are adequate to meet the needs of the surviving spouse.

2. Re-Examine Specific Bequests. Your estate plan may provide for specific gifts of cash or other assets to children, non-family members or charities, called *specific bequests*. Generally, specific bequests are “paid off the top” before the rest of the assets are allocated between the Marital and the Credit Shelter Trusts. With lower asset values it may be that when these specific bequests are satisfied at the time of your death, there will be insufficient assets left in Trust, or your estate, to provide for your surviving spouse or your children if they are the primary beneficiaries. Accordingly, you may want to “cut back” on these specific bequests or put in safeguards, e.g., “only if my estate exceeds \$500,000 do I leave \$50,000 to the following charity,” or some other adjustable formula that reduces the amount of the bequest to be paid to third parties.

3. Make Sure There is Liquidity. In the “good old days” when confronted with a highly illiquid estate, the assumption was that the decedent’s estate could go to a bank and borrow money using the decedent’s estate assets as collateral to raise cash to pay debts and expenses that come due on the decedent’s death as well as estate taxes that are due within nine months from the decedent’s death. The “old days” of walking into a bank confident of the ability to obtain a loan are gone. It is therefore important to make sure that there is sufficient liquidity in the estate to deal with estate tax uncertainties and other debts that will become due on death. Not only is liquidity lost through far lower values of stock portfolios, the ability to borrow your way out of an illiquidity corner no longer exists.

4. GRATs. Due to current low values and interest rates, now is an excellent time to consider the use of a Grantor Retained Annuity Trust (GRAT), particularly if you are optimistic that the stock market will soon “bounce back” to much higher values. The use of a GRAT is akin to making a loan. Assets are transferred into an irrevocable Trust, but the donor retains a right to receive an annuity stream from the Trust for a set period of time. The GRAT can be structured in such a way so no “gift” is made to the remainder beneficiaries of the Trust. In other words, a “zeroed out” GRAT can be established so that all of the assets that are initially transferred into the GRAT are, following the IRS’ tables, repaid to the grantor in the form of annuity payments. The significance is that if the assets that are transferred to the GRAT grow more rapidly than the interest rate in the month in which the GRAT receives the assets, all the residual assets that remain in the GRAT at the end of the annuity term are distributed to children, grandchildren, or other remainder beneficiaries gift tax-free. As such, the opportunity to

create a GRAT makes a lot of sense in light of the current low values that assets hold (which hopefully will recover) and the low interest rates that are used to value the IRS’ annuity payment obligation.

5. Family Limited Partnerships. Along the same lines as a GRAT, this might be an appropriate time to create and fund a Family Limited Partnership (FLP). While admittedly FLPs are on the IRS’ “most wanted” list, it is possible, due to the current poor economy, that valuation discounts in the gift of the limited partnership units to children and grandchildren will be more readily sustained merely by virtue of the existing market volatility. While conventional FLPs exploit valuation discounts associated with a lack of control and a lack of marketability, now if marketable securities are the assets held in the FLP a third valuation discount associated with market volatility might apply.

6. Roth IRA. While asset values are down, including investments held in an IRA, consider converting a regular IRA to a *Roth* IRA. The named beneficiary of a Roth IRA can enjoy a lifetime of tax-free distributions, which means a lifetime of a tax-free return on the investments held in a Roth IRA. Moreover, if the owner of the Roth IRA has a sizeable estate so that estate taxes are a consideration, removing the income tax from the owner’s taxable estate will add to the value of the ultimate inheritance. Regular IRAs can be converted to Roth IRAs, but there is a limit in 2009 that the taxpayer can only report \$100,000 of modified adjusted gross income. If the IRA owner has net operating losses from a business, those losses might make a Roth conversion feasible with a reduced adjusted gross income. Obviously, the conversion of a Roth IRA requires the owner to pay an income tax on the IRA amount that is converted to the Roth IRA.

These are tough times for our economy and for our portfolios. It would be a mistake to wait for the “final word” on potential tax rules, or for the stock market to finally “bounce back” before revisiting your estate plan. Take the time to look at your plan and confirm it still “works.” Moreover, confirm that there is sufficient liquidity to pay all debts, expenses and estate taxes that might be due on your death. The opportunity is now upon us to explore gift strategies in light of the current low values at no or a very low gift-tax cost.



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