

LEGAL Q&A

by Francis Burton Doyle, Esq., WealthPLAN

Q: What events suggest updating my estate plan?

A: 1) Marital separation or dissolution mandates revising your estate plan. After marriage, failure to revise your estate plan results in your new spouse receiving a statutory determined share of both your community and separate property, 2) One of the most important reasons to execute a Will is to name guardians for your minor child (ren). Also, as a child grows older events may require that his/her share of your estate be placed under the protection of a trust 3) Federal estate tax laws are in a state of flux as Congress debates the issue of permanent repeal versus increasing exemptions. Therefore, it is important to keep abreast of developments in the tax law and take appropriate action to update your estate plan. 4) If your wealth substantially increases it is important to investigate the utility of employing more advanced estate planning techniques in order to accommodate your wealth planning goals.

Q: How do we develop a family philanthropic legacy?

A: Families who establish a philanthropic legacy say that they receive far more than they give in the process of "giving back". Begin with discussions to assess areas of interests of your family members. Analyze the level of commitment that family members are able to make given existing obligations. Options exist at all levels of giving. The private foundation offers the greatest control over grant making; however, significant statutory compliance and reporting requirements must be met. With a donor advised fund established with your local community foundation the family could achieve effective control over investments and the direction of charitable gifting without the burden of regulatory compliance. A donor advised fund provides the family access to the community foundation's resources and allows them access a wide range of charitable needs in the community. The income tax charitable deduction varies significantly, so any contribution should be made only with the advice of your tax advisors.

Q: If my company is acquired or goes public, my net worth will increase substantially. How can I transfer wealth to my children in a tax efficient manner?

A: Among the wealth transfer strategies often used in this situation is the creation of a Grantor Retained Annuity Trust ("GRAT"). The grantor transfers shares to an irrevocable trust at the current low value and receives an annuity payment (in cash or in stock) for a term of years (i.e. 2 years) based upon that low value. Upon expiration of the term, all trust assets pass to the children. Because of the annuity payments, the gift of the remainder interest to the children is minimal. The payment "self adjusts" to remove exposure of a valuation adjustment challenge from the IRS. The caveat is that the grantor must survive the annuity term. If the grantor survives the GRAT term and the stock appreciates, then the stock price is transferred relatively free of transfer tax, thus preserving the estate tax exemption for future estate planning.

Q: My spouse and I have a living trust. If one of us dies, the survivor doesn't have to do anything, right?

A: Wrong. The purpose of a living trust is to allow you to administer the decedent's share of the estate without a probate proceeding. However, considerable work must be done. If assets were not transferred into the trust when it was created, there will be additional legal work necessary to fund the trust. The decedent's debts must be paid. Certain notices must be filed with the county and other agencies. Assets must be marshaled and valued. A final income tax return must be filed for the decedent. A federal

estate tax return may be required. If your trust document provides for division of the trust estate into sub-trusts at the first death, then an asset allocation must be prepared, the sub-trusts funded, and title to the assets changed accordingly.

Q: How is the 2008 election likely to impact my estate plan?

A: For the remainder of the calendar year, little impact is expected. However, the Republicans and President Bush, continue to seek full repeal of the federal estate tax. The Democrats seem committed to increasing the federal estate tax exemption to \$3.5 million. This increase would eliminate 90% of Americans estates from the estate tax rolls. As Congress struggles to find dollars in this difficult economy, only one thing is certain: debate will continue to be heated. In any event, the 2000 Economic Recovery Tax Act has left us with estate tax legislation that is in a state of flux and Congress will need to negotiate some compromise in order to instill stability in this arena. At the risk of sounding cynical, I anticipate no meaningful change in this untenable state of affairs until after the 2008 election. There is no political advantage for either party to take the action necessary to remedy the federal death tax law.

Q: My neighbor transferred his rental properties into a "family limited partnership". Should I?

A: There are several reasons why the "FLP" is the entity to own investment real estate. The partnership provides centralized management of the properties because the general partner manages the properties on behalf of the family. A limited liability company acting as the general partner affords an additional level of insulation from lawsuit judgments. Transfer restrictions on the partnership interests can insure that the family assets remain within the family. The transfer of partnership units allows for gifting on a leveraged basis, with discounts ranging from 25-45% for minority interest and lack of marketability allowed by the federal courts. Your estate will pass partnership units to your beneficiaries rather than an interest in each property, which prevents partition actions and the subsequent sale of a beneficiary's interest to an undesirable third party. A word of caution: beware of real property tax reassessment upon formation!

Q: Given the increasing federal estate tax exemptions, do I still need a Revocable Living Trust (RLT)?

A. Yes. First of all, remember that federal estate tax planning can be done in a Will or a Revocable Trust ("RLT"). However, even if your estate is not subject to federal estate tax, there remain several advantages to the RLT. Beginning January 2004, the Probate Court filing fees became a percentage of the estimated value of the Probate Estate. The filing fee for a Will for a 1 million estate has increased significantly. Executor's commissions and attorney's ordinary fees are also a percentage of testate value: \$23,000 for executor and \$23,000 for attorney's ordinary fees in a \$1 million estate. Extraordinary attorney's fees, such as services pertaining to the sale of real property, are additional. Of course RLT administration also involves fees, but overall, your estate should save substantial fees/costs if administered via a RLT.

Q: Will My Estate Owe Federal Estate Tax?

A: Maybe. If your Estate is over \$2M and depending on the year of your death, the following exemption and maximum estate tax rates apply: **2007** and **2008**: \$2M (45%), **2009**: \$3.5M (47%), **2010**; Estate Tax repealed. However, unless Congress acts, in 2011 the estate tax will return with an exemption of \$1M (55%), The House has twice attempted to enact permanent estate tax repeal. In June 2002 the repeal was defeated in the Senate. Repeal is again before Congress, and is expected to again fail in the Senate. Only 16% of voters polled in a three-year study by an independent research group felt cutting taxes was important, and removing the estate tax was almost the least desirable of possible tax cuts. Consequently, planning is still necessary to mitigate the estate tax.

Q: Does it matter whether I make a lifetime or Testamentary Gifts?

A: Yes. Currently, there is a discrepancy between lifetime and testamentary gifting. While the estate tax exemption/increase has now increased to \$2M, the gift tax exemption remains at \$1M. Given the disparity and the unsettled estate tax law environment, there are a few "axioms" to consider in gifting. First, always use the \$12,000 per donee annual exclusion. Second, defer the estate tax on the theory that exemptions will increase or the estate tax will be repealed. Third, never gift in excess of the \$1M gift tax exemption and preserve it by making gifts on a leveraged basis. Any lifetime gifting should be done in a manner, which incorporates the discounts allowed by the Federal courts. Fourth, utilize integrated planning techniques, which allow for highly tax-efficient transfers, thus preserving the exemption. Finally, always consult with your estate-planning attorney prior to transferring assets in excess of the annual exclusion.