



Now is the Time to Review Your Estate Plan

With low interest rates, low asset values and the uncertainty of the estate tax laws, now is the ideal time to review your estate plan. Putting off decisions until Congress acts or until asset values recover may be hazardous to your wealth.

Currently, each individual is entitled to a tax credit against federal estate taxes, which enables \$3.5 million to be excluded from the estate and pass tax-free. For married couples, the estate of the first spouse to die is entitled to a marital deduction for all property transferred at death to the surviving spouse; thus, the property passing between spouses passes tax-free. Assets which exceed the exclusion amount or pass to persons who don't qualify for the marital deduction are currently taxed at a 45% rate.

To reduce federal estate taxes, married couples can create trusts to fully utilize both exclusion amounts. The first decedent's exclusion amount does not carry over to the estate of the survivor -- it must be used at the first death or it is lost. By adopting trusts to preserve the exclusion amount of the first decedent, a married couple can currently transfer up to \$7 million tax-free upon both deaths, a savings of up to \$1,575,000 in federal estate taxes.

Anticipate Congress to change the following estate tax items over the next few years:

In 2010, the estate tax is scheduled to be repealed, but only for that year. Individuals who inherit assets in 2010 may discover an increase in their income tax because of the elimination of the full cost basis step-up. Currently, for income tax purposes, the cost basis of inherited assets is the fair market value of the assets on the decedent's date of death. However, in 2010, the cost basis for inherited assets will be the decedent's original cost basis in the assets (generally the purchase price), except for two key exceptions discussed below.

In 2010, the stepped-up basis rules will be modified. Up to a total of \$1.3 million in basis step-up may be allocated to assets transferred to beneficiaries other than a surviving spouse. An additional \$3 million of basis step-up may be allocated to transfers to a surviving spouse, for a total basis increase of \$4.3 million. For all other assets transferred at death, the basis will be the lesser of the cost basis of the decedent or the fair market value of the property on the day of the decedent's death.

In 2011 and after, the estate tax reverts to an exclusion amount of only \$1 million. Assets above that which are not passing to a spouse or a charity will be taxed at 45-55%, but the full cost basis step-up returns, such that the cost basis of inherited assets will again be the fair market value of the asset on the decedent's date of death.

Beginning in 2011, married couples who have trusts designed to fully utilize their combined exclusion amounts can only transfer up to \$2 million estate tax-free, a savings of up to \$450,000 in federal estate taxes. All assets above \$2 million are subject to estate tax of at least 45%.

H.R. 436, recently introduced in Congress, proposes to freeze indefinitely the exclusion amount at the current \$3.5 million and the estate tax rate at 45%, effective in 2010, but estates exceeding \$10 million would be subjected to an additional tax and full cost basis step-up would also continue.

This resolution also proposes to eliminate or reduce certain valuation discounts currently used in valuing corporations, family limited partnerships and family limited liability companies. In those cases, a qualified business appraiser may be able to justify a reduced value for estate tax purposes by claiming marketability and minority discounts. The combined marketability and minority discounts typically can range from 20% to 45%. These discounts often allow the transfer of assets at values lower than that of the underlying assets of the entity and save significant estate and gift taxes, so if you are thinking about making gifts of interests in a closely held business, you may want to complete the transaction in 2009.

You should also review whether your estate plan dispose of assets as you intended. Do you have the appropriate named executor, trustee and guardian for minor children? Does your plan eliminate or reduce estate taxes to the extent possible?

First, if you should die in 2010, does your executor have the authority to allocate basis step-up among the various recipients of your property in a manner that minimizes future estate or income tax incurred by your beneficiaries? Second, how will your trusts be funded if you die in 2009, 2010 or 2011, and is this what you intended? Will your surviving spouse have more or less control over the trust property than you anticipated? Third, can you do more now to reduce potential estate taxes by removing assets and appreciation from your taxable estate and pass them to your intended beneficiaries? Advisable strategies during these challenging economic times include making gifts, funding grantor retained annuity trusts ("GRATs") and making low-interest loans to or for the benefit of family members.

Gifts of property made during your lifetime are subject to federal gift taxes, but gifts up to \$13,000 to any person may be made annually free of gift tax (the "annual gift tax exclusion"). Spouses may double the annual gift tax exclusion to \$26,000 per donee. If the property transferred by gift appreciates in value, the post-gift appreciation will not be included in your taxable estate.

With estate tax rates of 45-55% in the next couple years, every dollar increase in your net worth means 45-55¢ more in estate taxes. On the other hand, for every dollar you give away tax-free during your lifetime, you can save 45-55¢ in estate taxes. Moreover, if depressed assets bounce back to their earlier highs or beyond, the post-gift appreciation will be transferred to your donees estate tax-free.

GRATs. If you own a business or other appreciating assets, consider a GRAT. To create a GRAT, assets are transferred to an irrevocable trust. You can be the trustee and choose the duration of the GRAT, usually as little as 2 years. During that time, the GRAT will repay you an amount equal to the assets initially transferred into the GRAT plus an IRS mandated annual rate of return (currently 2.4%). In essence, this is like a loan of the property to the GRAT, with you, the "lender," getting the principal back over the selected trust term plus 2.4% "interest." The objective is for the assets to appreciate during the selected term of the GRAT at a rate higher than 2.4%. It is not hard to envision a portfolio of marketable securities or other assets exceeding this rate of return over the next several years. The excess appreciation over 2.4% is a tax-free gift to the beneficiaries of the GRAT (typically your children). Congress may eliminate GRATs, so, again, consider whether this is something you should do in 2009 while interest rates are low and GRATs are still permitted.

Low-Interest Loans. Low-interest loans can help family members take advantage of an investment opportunity. If you have reservations about making a direct gift and a child is having trouble getting approved for a bank loan or only qualifies for unaffordable interest rates, you can lend money to your

child at interest rates below bank rates. These rates are set monthly by the IRS. For March, depending on the maturity of the loan, these rates range from .72% to 3.52%. In addition to making the loan, you can also forgive part of it each year through the annual gift tax exclusion. This powerful tool can help a family member purchase a new home or start a business. When making low-interest loans to family members, be sure to properly structure and document the loan.

The changing estate tax laws make it vital to be sure your current estate plan matches your objectives. With the many tools available, now is the time to plan to maximize these opportunities to transfer assets and their appreciation to the next generation. For help, please contact your CPM attorney to discuss your current estate plan and any changes.