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Estate Planning Alert

Part 1: Recent Wealth Transfer Tax Changes

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Increase of Estate Tax Exemption

You may recall that in 2001, Congress enacted legislation that gradually increased the estate tax exemption amount from $675,000 in 2001 to $3.5 million in 2009. In 2010, the estate tax is repealed in its entirety and the estate of any person dying in 2010 will pay $0 federal estate tax. However, because the 2001 legislation lacked the vote of 60 senators, the legislation "sunsets" in 2011 and the law reverts back to the law that existed in 2001, which would produce a $1 million exemption. The increase of the estate and gift tax exemption is set forth below:

Year	Estate and GST Tax Exemption	Gift Tax Exemption	Top Transfer Tax Rates
2001	$675,000	$675,000	55%
2002	$1 million*	$1 million	50%
2003	$1 million*	$1 million	49%
2004	$1.5 million	$1 million	48%
2005	$1.5 million	$1 million	47%
2006	$2 million	$1 million	46%
2007	$2 million	$1 million	45%
2008	$2 million	$1 million	45%
2009	$3.5 million	$1 million	45%
2010	Estate and GST Taxes Repealed	$1 million	35% Tax Rate of Gifts
2011	$1 million	$1 million	55% + 5% Surtax

In 2009, the estate tax exemption amount increased to $3.5 million per person. This means that, with proper planning, a married couple can transfer a total of $7 million ($3.5 million per spouse) to their family, free of estate tax. In 2008, the exemption amount was $2 million, so the increase is significant and quite meaningful for many clients.

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Coming Soon ...

Part 2: Potential Estate and Gift Tax Legislative Changes

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There are several implications of the increase of the exemption to $3.5 million.

First, it is important that married clients who have established "credit shelter trusts" or "by-pass trusts" or "family trusts," designed to shelter their estate tax exemption amount from inclusion in the surviving spouse's estate, have assets appropriately titled to fully fund the trust up to the $3.5 million amount. It may be necessary to re-title assets or change beneficiary designations to ensure that each spouse has the ability to fully fund their trust, up to the $3.5 million exemption amount, at the first spouse's death.

Second, in some cases, a client's estate plan may contain a formula that provides that an amount equal to the estate tax exemption amount goes to Beneficiary A, while the remainder passes to Beneficiary B. If a client with a $5 million estate executed such an estate plan in 2002, when the estate tax exemption was $1 million, Beneficiary A would receive $1 million, while Beneficiary B would receive $4 million. Under current law, because of the increase of the estate tax exemption to $3.5 million, Beneficiary A would receive $3.5 million, while Beneficiary B would receive $1.5 million. This may (or may not) be consistent with the client's intent and it may be appropriate to review the formula.

Finally, for many clients whose estates are below $3.5 million or $7 million, it may be appropriate to revise or even unwind complicated tax-driven trust structures. Most clients will generally fall into one of three categories:

Estate Less Than $3.5 Million

Clients whose combined estates are below $3.5 million could consider unwinding some of the complicated trust structures. Until 2009, a married couple with a $3.5 million estate would be subject to fairly significant estate tax without appropriate planning that sheltered assets from inclusion in the surviving spouse's estate through the use of a credit shelter trust or by-pass trust or family trust. Assuming Congress makes the $3.5 million estate tax exemption permanent, many clients can unwind these trust structures.

Before you consider unwinding any trusts or trust structures, it is important to remember that trusts serve very important non-tax purposes. Trusts are often used to assist in asset management, to distribute assets to beneficiaries at appropriate times and ages, to prevent the imprudent use of funds, and to protect assets from creditors, among many other reasons.

Estates Between $3.5 Million and $7 Million

The good news for many clients whose assets are between $3.5 million and $7 million is that, while they need to keep their trust structures (credit shelter trust, by-pass trust, or family trust) in place, they should be exempted from the payment of any estate tax. In 2008, a married couple with a $7 million estate and the appropriate trust structures would have nevertheless paid $1.35 million in estate tax; in 2009, the same married couple, with appropriate trust planning, will pay zero estate tax.

Estates Over $7 Million

The good news is that the estate tax exemption is significantly higher than it was last year. The bad news is that you still need to plan — perhaps aggressively — to mitigate estate tax. For estates of married couples over $7 million (or singles at $3.5 million), the tax rate is a flat 45 percent. Given the confiscatory nature of the estate tax, many clients are planning aggressively to reduce their estate tax liabilities.

Increase of Gift Tax Annual Exclusion

The gift tax annual exclusion for gifts of a present interest is $10,000 per person, per year. This amount is indexed for inflation. In 2008, the gift tax annual exclusion amount was $12,000; in 2009, the gift tax annual exclusion amount increased to $13,000.

Please remember that the gift tax annual exclusion applies to gifts to each person during the year. It is an annual exclusion based on calendar year gifts. Please also recall that <u>direct</u> payments of tuition expenses (private school, college, or graduate school) or medical expenses are not counted towards the $13,000 annual exclusion amount. The gift must be a gift of a present interest; gifts in trust do not qualify unless the trust contains a so-called "*Crummey*" withdrawal power, which gives the trust beneficiary (or his or her guardian) a limited right (typically 30 days) to withdraw the property gifted to the trust.

Gifting

Also, remember that gifting makes good sense. By gifting during your lifetime, you are doing several important things. First, you are removing the asset, any appreciation of the asset, and any income derived from the asset from your estate. A long term gifting program can remove substantial assets from your estate and greatly reduce estate tax.

Second, by gifting assets to your children and grandchildren, you get to see, during your lifetime, how they will use these assets and what types of stewards they will be with respect to the gifted assets. Will they save or use the assets wisely? Will they waste them foolishly? Frankly, it's a great opportunity to see what will happen on a much smaller scale.

Finally, gifting assets to your children during your lifetime is a great way to see how your gifts can make a meaningful and indelible impact on your children's lives. A client, a successful businessman, sold his business for many millions of dollars. What few people knew was that he had systematically and methodically gifted over 50 percent of the stock of his company to his children. Afterwards, I asked him how he felt that his children received

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more from the sale of the company than he did. His answer surprised me. He said, "It was the greatest thing I could have done – I get to see what a difference this will make in my children's lives during my lifetime, as opposed to never seeing it after my death. My son and daughter-in-law were able to move from their cramped home to a larger, more comfortable home for their growing family. My daughter-in-law no longer has to work to help support the family; she can now stay home and raise their children. It was a great decision and I have no regrets."

Not every family is alike, but this was certainly the right thing to do for this family.

What Should I Be Doing Now?

You may be asking yourself, "What should I be doing now, in response to these changes?

We recommend that you review your estate plan and the current titling of your assets. It may be appropriate to review funding formulas and the continued need for tax planning. In addition, it may be appropriate to re-title assets or update beneficiary designations to take advantage of the larger exemption amount.

If you have any questions about your estate plan or any planning techniques that you should consider, please feel free to call me or any of the estate planning attorneys at Williams Mullen.

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For more information on this matter and similar issues, please contact the author, Farhad Aghdami at 804.783.6440 or via email at aghdami@williamsmullen.com.

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Keep an eye out for Part 2, in which we will discuss potential estate and gift tax legislative changes.

About the Author

Farhad Aghdami works with high net-worth individuals and families, corporate executives, and business owners primarily in the areas of estate and gift tax planning, business succession planning, and general tax and corporate matters. Mr. Aghdami is a fellow in the American College of Trust and Estate Counsel and is listed in The Best Lawyers in America in both the Tax and Trusts and Estates categories. A 1989 graduate of the University of Virginia, he graduated in 1992 from Wake Forest University School of Law, where he received academic honors. Mr. Aghdami received his masters of laws in taxation from Georgetown University Law Center in 1995.

About the Trust & Estate Planning and Administration Practice

Williams Mullen offers an array of sophisticated estate planning services for the disposition of family wealth and the sheltering of assets from income, gift, estate and generation-skipping transfer taxes. Our experienced team of attorneys and paralegals also help individual and institutional fiduciaries handle the legal and tax complexities of estate and trust administration. Because estate planning calls for approaches and techniques that vary with the particular client's needs, the firm offers an array of estate planning services.

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