Fox Rothschild LLP
ATTORNEYS AT LAW

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TAX & ESTATES DEPARTMENT

# ALERT

## MANAGING THROUGH THE CRISIS/ HOW CURRENT ECONOMIC AND LEGAL DEVELOPMENTS COULD AFFECT YOUR ESTATE PLAN

### 75% Increase in "Unified Credit"

On January 1, 2009 the amount exempt from federal estate tax for U.S. citizens and permanent residents jumped from $2,000,000 to $3,500,000 ($7,000,000 for a married couple). This historic increase affects our clients in numerous ways:

- Clients with estates (including prior gifts) of less than $3.5 million will have few federal estate tax issues. On the other hand, state estate tax concerns will take on greater importance.
- Married couples with combined estates between $3.5 million to roughly $7.0 million still need to implement documents to "double up" on their credits. However, clients who have not recently reviewed and/or revised existing documents should do so as soon as possible in order to avoid:
  - *paying unnecessary state estate taxes on the death of first spouse to die*. **For example:** if your document automatically takes full advantage of the federal credit and you are a New York state resident, you will be hit with $229,200 in New York State estate taxes. Although paying state estate taxes now may lead to future federal tax savings, in many cases this may not make sense for you and your family. Factors to be considered include the size of the surviving spouse's estate and the potential future state of residence of the surviving spouse. Very careful planning and drafting are necessary to address this issue.
  - *misallocating the amount received by the beneficiaries of the credit bequest*. **For example:** suppose your estate is worth $5,000,000, and your will or trust allocates your full credit to children of a prior marriage, with the balance going to your spouse. If you were to die in 2009, the children would receive 70% ($3.5 million) of the estate and your spouse only 30% or $1.5 million.
  - *underfunding of the credit bequest due to insufficient assets being in the name of the first spouse to die*
  - *overfunding of the credit bequest*. **For example:** your estate is worth $4,000,000 and your will directs that a trust be created for the benefit of your spouse in the amount of the credit, with the balance left outright to your spouse. In this situation, $3,500,000 would end up in the trust, leaving only $500,000 subject to the unfettered control of your spouse. Again, proper advance planning is needed.
- In less than one year, the federal estate tax is to be repealed, but the broad consensus is that repeal is highly unlikely and that the credit will not be less than $3.5 million. There will be some tweaking in the tax law, but the bottom line: the time to review your plan and act is now.

### Fresh Look at the Revocable Trust

For our New York and New Jersey clients, conventional wisdom has been to keep the estate plan as straightforward and inexpensive as possible. Probate is not particularly onerous in the New York and New Jersey Surrogate's Courts; the choice between using revocable trusts versus wills is tax neutral. For the revocable trust to "work" for probate avoidance purposes, it must be funded during the grantor's life. All of this favors the use of wills over revocable trusts.

However, with the current topsy turvy financial climate, including an extremely volatile stock market, and Ponzi schemes abounding, the need to maintain uninterrupted control of estate assets has taken on added importance. To illustrate:

**Scenario 1:** A widow's husband died in October 2008. He was a permanent resident of the U.S. with approximately $4,000,000 in financial assets. Within a month of his death and before a personal representative could be appointed, the estate experienced a $1 million loss, putting the widow in a significantly worse financial position. Had a funded revocable trust been in place prior to death, the trustee would at least have been in a position to avoid or mitigate the financial loss. In a time of extreme market volatility, the benefits of a revocable trust are clearly superior,

as there is almost no delay in transitioning from the pre mortem to the post mortem phase.

**Scenario 2:** A client with roughly $30 million in liquid assets began to suffer loss of memory. Fortunately, she had implemented a revocable trust which provided for a successor trustee to replace the grantor/trustee upon medical proof of loss of capacity. The grantor's financial and physical well being continued to be addressed without interruption.

**Scenario 3:** An Asian client residing in the United States with significant U.S. situs assets died last year leaving his estate to beneficiaries in an Asian country. None of the beneficiaries speak English and the concept of estate planning is literally foreign in their jurisdiction. Legal and language issues were minimized as the client's assets were transferred prior to his death to a revocable trust.

## Historically Low Interest Rates and Depressed Property Values Create Opportunities for Wealth Transfer

Certain estate planning vehicles, such as the Grantor Retained Annuity Trust ("GRAT"), are particularly effective tools in a low interest rate environment. The GRAT is an excellent way to shift the growth of your assets to the next generation. To illustrate, suppose you took $10 million in assets (such as marketable securities) that you expect to grow significantly and transfer these assets to a two-year GRAT. The tax law requires that you get your original investment of $10 million returned over that two year period, together with a very low interest rate (3.4% as of this publication date). This works out to $5,256,518.00 for each of the next two years. If your "investment" grows by 10% over that same two-year period, $1,061,312.00 can be shifted to your beneficiaries gift-tax free. On the other hand, if the market falls even further, you just get back what you put in,without any tax penalty.

## Foreign Account Disclosure

Every person who files a tax return with the IRS must disclose on his/her 1040 whether the taxpayer has control over, or is the beneficial owner of, any foreign bank or other foreign financial accounts. If you answer this question in the affirmative, you are required to file a Form TD F 90-22.1, colloquially known as the FBAR. In its quest to uncover foreign accounts and unreported income, the IRS imposes steep penalties for noncompliance. The civil penalty is $10,000, unless noncompliance is due to reasonable cause and the transaction was otherwise properly reported. However, if the violation is willful, the stakes are much higher, both civilly and criminally. The $10,000 civil penalty can be increased to the greater of $100,000 or 50% of the balance in the foreign account. The criminal penalty for willful noncompliance is a fine up to $250,000 and/or imprisonment for not more than 5 years.

## What You Should Do Today

Every single estate plan should be reviewed as soon as possible. In today's complex economic and tax environment, each plan must focus on two elements: flexibility, which requires that documents be adaptable in order to deal with a changing tax environment, and responsiveness-the ability to act instantly and appropriately in a volatile economic atmosphere.

We are now incorporating drafting techniques into our documents to enable our clients to meet the needs of these changing times. While the shock of the market and the economy have created an inertia in many people, we urge the opposite. Let's climb out of the bunkers, take advantage of tax opportunities and interest rates that we have never before experienced and revisit our estate planning in order to manage and prosper under the current economic and tax environment.

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