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JANUARY 2009 NEWSLETTER

CURRENT STATUS OF ESTATE AND GIFT TAX AND PROSPECTS FOR CHANGES

In 2008 the estate tax exemption was $2 million for each individual who died. That is to say that each individual could pass in the aggregate $2 million to children, grandchildren, nieces, nephews, siblings, parents, friends or strangers. Recall that an unlimited amount may pass at death to a spouse or to a charity tax-free. On January 1, 2009 the estate tax exemption expanded to $3.5 million.

The gift tax annual exclusion in 2008 was $12,000, and that has increased in 2009 to $13,000, so each of us may give any and every calendar year $13,000 to as many people as we like free of gift tax or income tax. It does not matter whether those receiving the gifts are related or not. If we give an amount above $13,000 to any individual in any year, the surplus gift will also be free of gift tax (and income tax) if the $1 million gift tax exemption has not previously been exhausted, but must be reported to the IRS on Form 709 filed by the following April 15, and will exhaust some of the $3.5 million estate tax exemption. Up to $1 million of the estate tax exemption may be exhausted during life by gifts.

In 2008 each grandparent could at death make gifts to grandchildren in the aggregate up to $2 million (typically in trust for children for life, balance to grandchildren at death of children). This is the generation-skipping tax exemption. Transfers above this level are subject to generation-skipping transfer (GST) tax at 45% and typically also estate tax of 45% on whatever remains after the GST tax. The total tax is obviously confiscatory, over 70%, so such transfers are virtually never made. On January 1,

We were fortunate to be named in Washingtonian Magazine's December 2008 issue as among the 67 best Washington area trust and estates lawyers, and in The Washington Post/Legal Times listing of Washington's Best Lawyers, 2009 (excerpted from the publication *Best Lawyers in America*). Fred has prepared three speech outlines in 2008 which are posted on our website:

- "Planning for Uncertain Times," delivered to the National Capital Gift Planning Council
- "Offshore Asset Protection Trusts, Non-Tax Issues," at an ALI-ABA Seminar in Santa Fe for attorneys on International Estate Planning
- "Uses of Family Limited Liability Entities in Estate, Financial, Tax and Asset Protection Planning," to the National Association of Personal Financial Advisors in Rockville.

2009 the GST tax exemption expanded to $3.5 million.

On Monday, January 12, 2009 the *Wall Street Journal* in a front page article reported that "President-elect Barack Obama and congressional leaders plan to move soon to block the estate tax from disappearing in 2010." The law as passed during the Bush years had the estate tax disappearing in 2010, and returning in 2011 with a $1 million exemption and a 55% rate. While President Obama is expected to detail his estate tax preservation proposal in his budget next month, during the campaign President Obama detailed a plan that would lock in the estate tax "permanently" at a $3.5 million exemption and lock in the current flat 45% rate.

According to a November 2008 article in the *Wall Street Journal* Barack Obama supports "portability" of the estate tax exemption, which does not exist under current law, whereby any exemption not used by the first spouse to die, who, for instance, leaves everything to his surviving spouse, would be available to the surviving spouse at death. So if a couple had $7 million of assets, and everything passed to the surviving spouse in 2009, at that spouse's death $7 million could pass tax free.

We will report further if there are developments contrary to what we now expect, but it appears that the $3.5 million exemption and 45% tax rate will be the law for the foreseeable future, and portability <u>may</u> become law in 2009. It has been estimated that a $3.5 million exemption will result in 8,000 estates per year owing taxes (0.3% of decedents). If you fall into that category, it is not clear whether congratulations or consolation is appropriate.

We would be happy to discuss with you how this expansion of the estate tax exemption will affect your existing estate plan and how you might update an obsolete plan.

<u>HARD ECONOMIC TIMES CREATE PLANNING OPPORTUNITIES</u>

There is a silver lining to the recent economic downturn: today's climate of relatively low stock values and low interest rates creates opportunities to transfer wealth to younger generation family members at a significantly reduced gift tax cost. At the simplest level, (1) outright gifts of securities with temporarily depressed values to family members (or gifts to custodial accounts or trusts for minor family members) are more attractive today because a larger number of shares may be transferred at a reduced gift tax cost, and (2) intra-family loans (for example, to help adult children buy a home or start a business or buy a portion of the family business) are more attractive today because the minimum interest rate that must be charged to avoid the gift tax consequences of a below-market loan are quite low – in January 2009, just .81% must be charged for a short-term loan (under 3 years), 2.06% for a mid-term loan (3-9 years), and 3.57% for a long-term loan (9 years-plus) (with annual compounding). In February the rates will be even lower: .6% for short-term loans, 1.65% for mid-term loans, and 2.96% for long-term loans.

Moreover, low stock market values and low interest rates make this an excellent time to implement more complex estate planning strategies such as grantor retained annuity trusts (GRATs) and charitable lead trusts (CLTs), both of which involve transferring a remainder interest to one's children or grandchildren after a term of years in which an interest is retained by the grantor (in a GRAT) or distributed to charity (in a CLT). In a GRAT, a grantor transfers assets (typically securities) to a trust, retaining an annuity income interest for some period of years at the end of which the remainder interest passes to his children or grandchildren. In a CLT, a grantor transfers assets to a trust from which one or more charities receive a payout for a number of years, at the conclusion of which the remaining trust assets pass to his children or grandchildren. Lower interest rates result in a lower actuarial value of the remainder interest passing to the grantor's children or grandchildren at the conclusion of each of these arrangements, thus reducing their gift tax cost. In addition, both of these strategies produce greater benefits when the transferred assets increase in value much faster than the rate of return/interest rate presumed by the IRS, a result that is much more likely when stock values and interest rates are depressed (assuming, of course, that they rebound in value as expected). Many financial planners believe that today's financial climate presents a historic opportunity to pursue such wealth planning strategies. With interest rates

possibly rising later in 2009, now is the time to utilize the strategies and assist our clients with them in their estate planning. Please let us know if you are interested in discussing any of these approaches.

ECONOMIC CRISIS MAY REQUIRE AN UPDATED LOOK AT LIFE INSURANCE NEEDS AND MAY MAKE COMMERCIAL ANNUITIES MORE APPEALING

Many of us have experienced in the range of 40% shrinkage of our net worth, based on the precipitous decline in the value of our homes and securities portfolios, including our 401(k) and IRA retirement plans. This may expose some families to great financial jeopardy on a premature death, particularly of the principal breadwinner. The remaining assets at present values may be insufficient to sustain a spouse and/or children in their accustomed manner of living. A short term inexpensive solution may be additional life insurance, perhaps 10-year level premium term policy, which may cover the shortfall while asset values recover over the next decade.

Cash value life insurance and commercial annuities (available through life insurance agents, stock brokers and other licensed professionals) may be more attractive in the current environment in which any sort of future return on securities may be very uncertain. Fixed (as opposed to variable) annuities from very financially sound insurance companies (some weaker ones may fail in the current downturn) may guarantee a certain rate of future return (5%-6%), and certain types of cash-value-type life insurance may guarantee certain internal rates of return which are income tax sheltered. Investments with such guaranteed returns may have a place in reconstituted investment portfolios after the recent stock market crash. At retirement cash values in life insurance policies may be accessed income-tax-free as low-interest rate loans to supplement retirement income.

CHANGING TRUSTEES, INVESTMENT MANAGERS IN TURBULENT TIMES

Has the institutional fiduciary managing or named to manage trust assets for your family been sold (e.g., Merrill Lynch Trust Company, Wachovia Bank) or disappeared, or is it in financial turmoil? If so, you may want to consult with us regarding a possible update to your own documents to select a more stable institution or, in any existing trust, to explore your options to remove/change trustees.

Has your investment advisor/manager been sold or is it the subject of newspaper articles for its financial troubles or are you dissatisfied with its under-performing the down market? If so, we can talk to you about other better choices available to you and, depending on your preferences and circumstances, introduce you to sounder advisors for you to interview.

PRENUPTIAL AND POST-NUPTIAL AGREEMENTS

A subset of our practice is preparing marital agreements, and we were listed in a recent issue of Washingtonian magazine as prominent in this field. Two sorts of lawyers prepare marital agreements, divorce lawyers and trusts and estates lawyers. Frankly, divorce lawyers are more inclined as a result of their practice and experience to be aggressive, contentious, and Abig picture,@ whereas trusts and estates lawyers tend to be lower key, conciliatory, and detail-oriented. We find that our model works best in Agetting to yes@ in pre-nuptial and post-nuptial agreements, but we frequently find ourselves negotiating, usually cordially and constructively, with divorce lawyers.

What can a marital agreement accomplish? It can clearly establish the rights and obligations of each spouse in the event of divorce or death and thus avoid expensive, time-consuming and emotionally draining litigation. In its simplest form, a marital agreement might provide that neither spouse has any obligation whatsoever to the other in the event of death or divorce. Alternatively, it might provide that one or both of the parties has certain obligations to the other in the event of death and/or divorce, but has no additional obligations beyond those explicitly set forth in the agreement. In many cases, the wealthier spouse will agree to make certain provisions for the less wealthy spouse, sometimes in accordance with a Avesting@ schedule based on the length of the parties= marriage.

Marital agreements are valid and enforceable in all American jurisdictions, so long as they are

entered into freely and voluntarily by both parties, and with full disclosure of both parties= assets and income. Each party should be represented by separate counsel, and ideally prenuptial agreements should be signed well in advance of the wedding to avoid any argument that either party entered into the agreement under duress.

GUEST ARTICLE

"LONG TERM CARE PLANNING"

by John Tansill
of Morgan Stanley, Alexandria, VA

As America's population ages, we will see an increasing need for our "long term care." Most often defined as a mix of medical and support services for those with disabilities and chronic care needs, long term care can be delivered at home, in an adult day care center or through another type of community program, in an assisted living facility, or in a nursing home.

Long term care is not intended to cure people. Long term care is care that you need if you can no longer perform everyday tasks such as bathing or dressing by yourself due to a chronic illness, injury, disability or the aging process. It requires primarily custodial, not skilled care. Custodial care is assistance with the activities of daily living. Skilled care can be administered only under a plan of care prescribed by a qualified physician and executed by a skilled nursing staff.

Long term care also includes the supervision you might need due to a severe cognitive impairment and can result from conditions such as Alzheimer's disease. Alzheimer's disease and related dementias are the greatest long term care risk older Americans will face. Alzheimer's threatens the financial security and physical and emotional well-being of as many as 16 million (one in six) baby boomers who could come down with the disease by mid-century.

While many people think of care in a nursing home when they hear the words "long term care," there is a much wider array of services to support people who need long term care. Among them are in-home health care, adult day care centers, assisted living facilities, adult family care homes, continuing care retirement communities, and many others. In fact, most long term care is provided at home, either by paid providers like home health aides, personal care workers or nurses and therapists, or even by unpaid caregivers such as family or friends. As the population lives longer, but with chronic illness, we will need more loving hands to ably help us with tasks of everyday living. While caregiving has been a balancing act for family caregivers, changes in the American family as well as the entry of many women into the workforce have placed pressures on the traditional family caregiving structure. For those without family and friends available, or with conditions that require professional help, there will be increasing reliance on the paid caregiver workforce.

The most important issues for those researching long term care options are the cost, availability, and type of long term care. For most of us, the critical issue is cost. Who pays for long term care? Quite simply, you do!

By one estimate, the average cost of care in a nursing home in 2006 was $78,392 for a person in a private room; $67,965 for a semiprivate room. Actual costs are much higher in certain areas of the country – in Washington D.C., the average in 2007 was $109,865 for a private room and $88,534 for a semi-private room, and $60,372 for assisted living facilities. Also noteworthy is the fact that more assisted living facilities are providing dementia care (59% versus 48% in 2006) and that the additional costs for those services average $1,110 per month nationally. Looking ahead, the American Council of Life Insurers projects that if the cost of nursing home care keeps climbing at an annual rate of 5.8% (which is what the average increase has been since 1990) the cost of a private room in a nursing home in 2030 in the D.C. area would be $401,818 per year.

The cost of long-term care surpasses the ability of most families to pay for it out of pocket. Thus third party payments are vital. The average length of stay in a nursing home is just over two years, but there is great variability in the duration of stays, with about 5 percent of residents staying 5-10 years from the time of admission.

And while government programs such as

Medicare and Medicaid exist to assist people with their health care needs, they were not designed for the costs of today's medical technology nor were they designed for an era of ever-increasing life expectancy.

Medicare is the federal government's health insurance program for the disabled and those 65 years of age and older. Many Americans believe Medicare will pay their long-term care bills, but in fact it pays for only a small percentage of all nursing home costs. Medicare pays for skilled nursing facility (SNF) care for a limited period of time – at no cost to the beneficiary for the first 20 days, and with a co-payment in 2007 of $124 per day from day 21 up to day 100, at which point coverage ceases. SNF care is designed to help rehabilitate patients following hospitalization, and is time limited.

The biggest gaps in Medicare's long term coverage are:

- No coverage for custodial care, either at home or in a nursing home.
- No coverage for nursing home stays without prior hospitalization
- No coverage for nursing home care after 100 days
- Coverage only in a Medicare-approved facility

Medicaid is the federal government's nursing home program. It is a means-tested program with strict financial limits on beneficiaries' income and assets. An individual must exhaust nearly all of his or her own financial resources before qualifying for nursing home coverage. Limitations on the financial assets a person may keep before Medicaid will pay for nursing home services can be as low as $2000. Legislation enacted in 2006 substantially tightened the rules for Medicaid eligibility.

As with other types of health care coverage, there exist a myriad variety of insurance programs for long term care coverage.

Those with the means can self-fund their own long term care, although estimates vary as to just how affluent you need to be. Some experts put the figure as high as $5 million in net worth. One key selling point for long-term care ("LTC") insurance is its potential to protect your nest egg by funding long-term care, so even individuals who could handle such expenses may want to explore the coverage in that light.

As for when to buy it, some financial planners say clients over the age of 55 should consider the purchase of LTC insurance, but believe that the most cost-efficient time to purchase such coverage is between 60 and 65. Others prefer the sooner-rather-than-later strategy and suggest that buyers in their 40's and 50's take advantage of much lower premiums, although buying coverage at 65 is still not cost prohibitive. Premiums vary greatly, but estimates show that a 60 year old with no preexisting health conditions can usually buy a policy with good coverage for $4500 to $7000 annually. The key is to develop a long term care insurance plan that fits your budget and your needs.

Helpful Tips:

When you are ready to buy long term care insurance, it's very important to have inflation protection, especially if you are buying a policy in your 40s, 50s, or 60s. After all, if you buy a specified dollar amount daily or monthly benefit based on today's provider costs, that benefit is not going to keep up with rising costs over the 10, 20 or even 30 years that may pass before you need the benefits --- unless you have inflation protection. The good news is that one of the latest options available in some policies is automatic inflation coverage tied to the Consumer Price Index (CPI).

Automatic inflation coverage tied to the CPI works like this: Every year on the policy anniversary, your long term care insurance coverage amounts are automatically adjusted according to the CPI. When the CPI increases – even during periods of the highest inflation like in the 1970's – your benefits increase accordingly, but your premium remains the same. In the unlikely event that the CPI decreases – which last happened in 1955 – your benefit amount will not be reduced.

In addition to having inflation protection, another tip to buying the right LTC insurance for you is to avoid purchasing more insurance than you need. The first step is to research the costs of home health care, assisted living facilities, and nursing homes in your area. Don't rely on national average numbers because costs can vary greatly

from city to city and region to region. For example, nursing home prices in Roanoke, VA are materially cheaper than they are in Washington, D.C.

Once you know the costs, you'll have a better understanding of the daily benefit you need to cover those expenses. In addition, be sure to include in your calculations the estimated increase in cost based on the inflation rate or CPI over 10, 20 or 30 years. Remember that a nursing home is probably the worse-case scenario, and that most people receive care at home or in assisted living facilities which tend to be less costly, and LTC insurance will pay for care in those environments as well, not just in nursing homes.

So is planning for long term care insurance worth it? Few people regret purchasing car or home insurance when an accident takes place. The coverage earned is far greater than the annual premiums paid, especially when you consider the alternative: paying for a new car or a new home out-of-pocket. The same is true of long term care insurance. The benefits paid out under a LTC insurance policy for one year alone can often exceed the cumulative premiums you pay into the policy over many years. More important, long term care insurance helps to protect your retirement savings and allows you more independence and choice in how and where you receive your long term care services when you need them.

Our November 2006 Newsletter (posted on our website) includes an article about the Deficit Reduction Act of 2005 and how that law makes it much harder to qualify for Medicaid nursing home care. Basically, everyone but the very poor will have to self-insure/self-fund nursing home care or buy long-term care insurance.

INTERNATIONAL ESTATE PLANNING

There are many international families with members in both the Washington area and overseas. Those in the U.S. may be citizens or resident aliens with Agreen cards@ or applying for permanent resident status. Others in our area are non-resident aliens because of diplomatic status (e.g., as employees of World Bank or IMF, etc.), but may want to stay in the U.S. and apply for permanent resident status immediately upon retirement. Frequently there are grandparents, parents or siblings living outside of the U.S. who will never be U.S. citizens or permanent residents.

The income tax rules affecting resident aliens and non-resident aliens on U.S. source income are quite complex, and planning strategies may be available to minimize the income tax burden.

The transfer tax rules affecting lifetime gifts and testamentary (death) transfers of funds and assets cross border are even more complex and planning strategies are frequently critical to avoid unnecessary taxes which may be very substantial.

In the case of both tax regimes, tax treaties between the U.S. and the country of citizenship of the non-resident alien family member may alter the general statutory treatment in the Internal Revenue Code.

EXAMPLE A: Hong Kong resident Chinese citizen buys office building in Tysons in his own name as an investment. Even if he never visits the U.S. he will be subject to U.S. tax at 45% at his death on the full value of the property not reduced by the mortgages, with no or virtually no estate tax exemption available. In contrast, if he had established an offshore trust structure, e.g., in Singapore, with a Bahamian corporate subsidiary, which in turn owns a Virginia LLC which owns the building, at his death he would be deemed to own a Singapore trust not U.S. real estate, and would not be subject to any estate tax.

EXAMPLE B: Swiss citizen mother wishes to give $500,000 in jewelry and paintings and $500,000 of cash to U.S. citizen daughter. If the transfers are made while she is in the U.S., $1 million may be subject to gift tax at 45% with no exemption. In contrast, if the transfers of tangibles take place in Geneva and the gift of cash by wire transfer into daughter=s Zurich account, no gift tax would be due.

Fred recently delivered an outline covering these and other international income and estate planning issues to the Virginia Society of CPAs. We have posted his lengthy outline on our

website. If you have any questions about international estate or income tax planning issues, please contact Fred Tansill.

COORDINATING LIFE INSURANCE AND RETIREMENT BENEFITS WITH THE ESTATE PLAN

In general, life insurance and retirement benefits are not controlled by your Will or Revocable Trust; rather, these benefits pass at your death to the persons you have indicated on a beneficiary designation form filed with the insurance company or retirement plan custodian or plan administrator. It is therefore extremely important to carefully consider these designations, to coordinate them with your overall estate plan, and to update them when and if your circumstances change.

In most instances it is desirable for a married individual to name his or her spouse as primary beneficiary of all retirement plans and IRAs. (A spouse must by law be named as the primary beneficiary of employer-sponsored retirement plans covered by ERISA -- 401(k) Plans but not IRAs -- unless the spouse waives that right in writing.) It is desirable to name a spouse because a surviving spouse, unlike any other beneficiary, can elect to roll such plans into his or her own IRA and delay taking distributions until he or she reaches age 70 2 (or more accurately, until April 1 of the calendar year after the year in which he or she reaches age 70 2), thus enjoying tax-free growth and deferring the income tax on these distributions for as long as possible. You may name a Marital Trust for the benefit of your spouse established by your Will or Revocable Trust as beneficiary of such plans (assuming the spouse waives the right to an outright distribution in the case of ERISA plan), and this may be appropriate if you want to control the disposition of the balance remaining in these plans after your spouse=s death, e.g., in cases where the spouse is not a parent of the plan participant's children. Distribution of retirement benefits to a Marital Trust will qualify for the federal estate tax marital deduction, and it will achieve some income tax deferral in that distributions may be made over the spouse=s life expectancy, but periodic distributions to the Marital Trust must begin relatively soon after the participant=s death and will be subject to income tax as they are made.

If your children are responsible adults, it is generally preferable to name them as primary beneficiaries (if you are not married) or as secondary beneficiaries of your retirement plans if your spouse is the primary beneficiary. (You should indicate on the beneficiary designation form that if a child does not survive you, his share passes to his descendants, per stirpes; otherwise such share may pass to other siblings.) It is prudent to name individual beneficiaries because individual beneficiaries (as opposed to trusts or estates) generally have the most flexibility under our tax laws to take these distributions over the longest period of time (sometimes over the beneficiary=s entire lifetime) and thus obtain the greatest possible income tax deferral. However, if your children are minors or if you do not believe they should receive assets outright, it may well be preferable to name trusts for your children as beneficiaries of retirement plans despite the potential income tax disadvantages (a complete discussion of which is beyond the scope of this article). Because the distribution of life insurance does not have income tax consequences to the beneficiaries, there is more flexibility in naming life insurance beneficiaries than in naming retirement plan beneficiaries. In some cases life insurance policies should be owned by an irrevocable life insurance trust, and payable to that trust as primary beneficiary, in order to remove the insurance from your taxable estate. You may name a revocable trust or an estate as primary beneficiary of your life insurance without adverse income tax consequences, and this may be the appropriate choice in order to coordinate the disposition of the insurance with your overall estate plan. If your Will or Revocable Trust creates a bypass trust for your spouse and children, naming your estate or the Trustees of your Trust as primary beneficiary of your life insurance can make assets available to fund that share. If you have a simple estate plan leaving everything to your spouse and then your adult children, it is appropriate to name your spouse as primary beneficiary and your children as secondary beneficiaries of your insurance.

Because the beneficiary designations on life insurance policies and retirement plans can control the disposition of a significant portion of many estates, it is important to ensure that they are carefully coordinated with your estate plan to effectively implement your overall estate planning strategy.

USE OF DISCLAIMERS IN POST-MORTEM ESTATE PLANNING

Disclaimers can be an extremely useful tool both in estate planning and in Arearranging@ the disposition of an estate after someone has died.

Simply put, a disclaimer is a refusal to accept a gift or inheritance. To be effective for estate planning purposes, a disclaimer must be Aqualified@ within the meaning of Internal Revenue Code Section 2518, that is: (1) it must be in writing; (2) it must be irrevocable and unqualified; (3) it must be made and effectively delivered within nine months of the transfer creating the disclaimed interest (or within nine months of the date the disclaimant attains age 21); (4) the disclaimant must not have accepted any benefits of the disclaimed interest prior to making the disclaimer; and (5) as a result of the disclaimer, the disclaimed interest must pass either to persons other than the disclaimant or to the spouse of a decedent. When a qualified disclaimer is made, the disclaimant is treated as if he is deceased, and the disclaimed property passes to the persons designated to receive the property in the event of the disclaimant=s death. A person who makes a qualified disclaimer has NOT made a gift to the recipients of the property; rather, the transfer is deemed to have been made directly from the original transferor to the recipients without passing through the hands of the disclaimant.

In many cases estate planning documents for a married couple are drafted to explicitly provide for the possibility of a disclaimer by the surviving spouse. Suppose that a married couple has assets worth $3.5 million. Currently, one spouse=s $3.5 million exemption is sufficient to shelter their entire estate from tax, and they would prefer a simple Asweetheart@ Will leaving all to the survivor at the first death. However, their estate is increasing in value and by the time the first spouse dies it may be desirable to take advantage of some or all of the deceased spouse=s exemption. This couple could benefit from standby tax planning in the form of a disclaimer trust. Their documents would provide for an outright distribution of the entire estate to the surviving spouse at the first death, but would further provide that any property disclaimed by the surviving spouse would pass to a disclaimer trust which would benefit the surviving spouse and children for the spouse=s lifetime and then pass tax-free to the children at the spouse=s death. Such a plan gives the surviving spouse the flexibility after the spouse's death to take the entire estate outright if that is appropriate, or to implement tax planning using some or all of the deceased spouse=s exemption if that is necessary after taking into consideration the size of the estate and the amount of the estate tax exemption then in effect and available to the deceased spouse. In the example above, if the first spouse dies while the couple=s assets are still worth not more than $3.5 million, the surviving spouse probably would not make a disclaimer. If, on the other hand, the estate had grown to $6 million by the first death but the estate tax exemption remained at $3.5 million, the survivor would likely choose to disclaim $3.5 million and take full advantage of the deceased spouse=s exemption.

Disclaimers can also be used to rearrange estate plans after death even where the estate planning documents do not specifically provide for them. A well-to-do adult may choose to disclaim an inheritance from her mother to allow it to pass to her own children. A widow who owned substantial assets jointly with her late husband may wish to disclaim some or all of her late husband=s putative 50% interest in the joint assets and allow them to pass to her children or to a bypass trust created under the husband=s Will or revocable trust in order to take advantage of his estate tax exemption.

As noted above, there are very specific requirements and deadlines for making a Aqualified@ disclaimer that is effective for transfer tax purposes. Therefore, persons considering disclaiming an inheritance should consult with an estate planning professional as soon as possible after the decedent=s death.

GST PLANNING AND DYNASTY TRUSTS

The generation-skipping transfer tax (AGST@) is a supplemental transfer tax imposed in addition to the estate or gift tax on transfers to individuals deemed to be two or more generations younger than the transferor (for example, grandchildren and grandnieces or grandnephews). Each individual has a $3.5 million exemption from the GST tax which can be used to shelter lifetime gifts

or transfers occurring at death. The GST tax rate is equal to the highest transfer tax rate in effect at the time of the transfer (currently 45%).

Because of the high rate of the GST tax and the fact that it is imposed in addition to the estate or gift tax, it is rarely advisable to make generation-skipping transfers in excess of the exempt amount. However, it is often advisable for high net worth individuals to take advantage of their $3.5 million GST exemptions ($7 million per couple) by transferring up to the exempt amount to a lifetime or testamentary trust for the benefit of their children for as long as they live, and at the children=s deaths tax-free to grandchildren. Such a trust is structured so that the trust assets are not included in the estates of any trust beneficiaries until they are actually distributed to the beneficiaries. If the GST exemption is properly allocated to all transfers to the trust on a gift or estate tax return, no distributions from the trust will ever be subject to GST tax no matter how large the trust grows. The longer such a trust continues, the greater the tax benefits obtained. Historically, although certainly not lately, money invested in the stock market can be expected to grow at nine percent (9%) or more each year, and according to the ARule of 72" assets which grow in value by 9% each year after taxes will double in value every 8 years. Thus $4 million placed in a GST trust and invested in stocks might be expected to grow to $8 million in 8 years, $16 million in 16 years, $32 million in 24 years, $64 million in 32 years, and so on. The potential tax benefits can be staggering.

Lifetime generation-skipping trusts are typically funded with life insurance, either a second-to-die policy on the joint lives of a husband and wife or a policy on an individual life (because applying exemption only to the premium payments will shelter the full face value of the policy from tax) or with other assets likely to increase in value. Using this technique, the $1 million lifetime exemption and GST exemption may be leveraged 10-to-1 or 20-to-1, to make this a very powerful estate planning tool.

A dynasty trust is a generation-skipping trust designed to continue for the maximum period allowed by law. The Internal Revenue Code itself does not limit the duration of GST-exempt trusts; instead, this issue is governed by state law. Until fairly recently, the duration of trusts was limited in all American jurisdictions by the common law Rule Against Perpetuities (which provides that trusts must terminate within twenty-one years after the death of persons who are living at the time the trust is created) or by some statutory approximation thereof (for example, that no trust may continue for more than one hundred years).

In recent years, some American jurisdictions, including Virginia and Maryland, have abolished the Rule Against Perpetuities at least for some types of trusts holding some types of assets (typically, assets other than real estate). It is now possible to set up a GST-exempt trust in one of those jurisdictions which could, in theory, continue forever without being subject to GST tax or estate tax at the death of any of the future trust beneficiaries. There has been speculation that Congress may someday act to limit the tax benefits of perpetual trusts, but no such legislation is currently pending. If such legislation is enacted, it is possible (although not certain) that existing perpetual trusts would be Agrandfathered.@

There are also important non-tax reasons to consider the creation of lifetime discretionary trusts for the benefit of children, grandchildren and more remote descendants. Such trusts are exempt from most types of creditors claims= (including the claims of a beneficiary=s spouse in the event of divorce, although generally not from child support claims and claims by governmental entities), can provide a safety net to protect beneficiaries from their own imprudence or ill fortune, and can prevent beneficiaries from becoming Aspoiled@ and living off their inheritances rather than working.

BROOKE TANSILL IS WORKING WITH US

Brooke C. Tansill has been working with us since September. A graduate of Bowdoin College and the Sandra Day O’Connor College of Law at Arizona State University, she has passed the Arizona Bar and is waiting on the paperwork to be sworn into that Bar, and will waive into the District of Columbia Bar in 2009.

FEEDBACK FROM YOU

If you have any questions about any of these issues, please e-mail or call Fred Tansill for clarification or elaboration. If you hear or read

about a tax development or planning opportunity or will or trust or incapacity or other related issue that you would like to know more about, please do not hesitate to call us. We undoubtedly will have an outline or article on point in our files which we can share with you. We welcome suggestions from you as to matters you would like to have us explain and evaluate in future mailings to you.

We welcome your ideas and comments with respect to any aspect of the way we conduct our practice. We try to provide highly responsive sophisticated service at a reasonable price, but we know we do not always succeed. We constantly strive to improve. We will accept your criticisms with good grace and your suggestions for improving what we do or how we do it with gratitude. Feedback from you is very important to us. If you would like us to provide services that we do not presently offer, let us know that. We expect to grow and evolve. If you are looking for copies of anything from your files or have any housekeeping questions, please do not hesitate to contact Sherry at sherry@fredtansill.com.

CAN WE HELP YOU FIND OTHER PROFESSIONALS?

One service we are happy to provide is to refer you to other professionals in whom we have confidence, with whom we have worked productively, lawyers in other specialties or non-lawyers, including the following: life insurance agents, banks and trust companies, investment advisors and managers and stockbrokers, fee-based financial planners who sell no product, financial planners/investment advisors who do sell product, accountants and tax specialists, appraisers, real estate lawyers, property and casualty insurance agents, deferred compensation consultants, estate sale auctioneers and specialists, domestic relations/divorce lawyers, elder lawyers, attorneys specializing in guardianships and incapacity, labor and employment law, litigation, and estate planning and probate counsel in jurisdictions outside of our area. We take a great interest in all matters which impact on the prosperity and financial security of our clients and in all strategies which minimize or alleviate their tax burden.

11TH ANNIVERSARY OF OUR FIRM

Our firm was founded in November of 1997, and so we are now in our 12th year. We are grateful to our older and newer clients who continue to trust us to advise you on your legal and tax matters. You may rely on the fact that we will always be diligent and thorough in giving prompt attention to your inquiries and requests for help, and we will be sensitive to the costs.

YOUR E-MAIL ADDRESS FOR OUR DATA BASE

We would like to add your e-mail address to our database and generally to update our information on your address, phone and fax numbers. One of our future goals is to be able to e-mail our newsletter and other announcements to you more frequently, bringing you up-to-date on pertinent changes in the estate and tax laws and keeping in touch.

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