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MARCH 2015 NEWSLETTER

Continued Growth of the Federal Estate and Gift Tax Exemption by Inflation Adjustment

The 2012 change in the federal estate, gift, and generation-skipping transfer tax ("federal transfer tax") provides for automatic future increases in the federal transfer tax exemption based on inflation. In 2014 the exemption was $5,340,000. The exemption for 2015 is $5,430,000 (an increase of $90,000). The exemption may be expected to increase by $80,000 - $100,000 per year.

Planning Idea: Any clients who previously exhausted all of their transfer tax exemptions by gift now have as of January 1, 2015 another $90,000 they may give away during life (or at death) tax-free.

As for the available transfer tax exemption at death, we draft our documents to take advantage of whatever the exemption is when our clients die, so documents drafted by our firm will take full advantage of whatever the exemption is in the year of death, taking into account any lifetime gifts made which reduce the available exemption.

Developments for Maryland Residents

Maryland has a state estate tax – which is in addition to the federal estate tax but is deductible from the gross estate for federal estate tax purposes – on estates above $1 million that pass to anyone other than a spouse or charity. (Note: Virginia repealed its state estate tax years ago.) At one time this Maryland exemption was coordinated with and identical to the federal exemption, but over the last decade as the federal transfer tax exemption has grown to the 2015 level of $5,430,000, Maryland's exemption has remained static at $1 million. The expansion of the federal exemption over the past few years has caused the Maryland legislature to become concerned that the onerous state estate tax would cause wealthy older Marylanders to move out-of-state to jurisdictions such as Florida and Virginia with no state estate tax, thereby eroding the Maryland income tax revenue base.

To address this concern, the Maryland legislature agreed in 2014 to raise Maryland's estate tax exemption in phases until 2019 when it will conform with the federal transfer tax exemption,

and thereafter it will remain conformed with and identical to the federal exemption, however the federal exemption changes in the future.

The schedule by which the Maryland estate tax exemption will increase is as follows:

2015	$1.5 million
2016	$2 million
2017	$3 million
2018	$4 million
2019	Same as the federal transfer tax exemption

Maryland law does NOT recognize the concept of "portability," i.e. the federal estate tax concept by which the estate tax exemption unused by the first spouse to die may be used by the surviving spouse. Maryland law recognizes the efficacy of a Maryland-specific QTIP marital trust to minimize Maryland estate tax.

Developments for District of Columbia Residents

The District of Columbia also has an estate tax on estates above $1 million. D.C. has a long history of following Maryland's lead in estate matters. Maryland's decision to expand its estate tax exemption in phases to match the federal exemption apparently influenced the D.C. City Council, which was inclined to mimic Maryland's change. But reduction of taxes on the wealthy is more politically sensitive in D.C., so the Council and Mayor, after negotiations, determined to phase-in the expanded exemptions only if, as, and when certain budget revenue targets are met. The first relevant determination will be made in May-June 2015. Assuming the budget revenue targets are met, D.C.'s estate tax exemption will phase up to conformity with the federal exemption as follows:

2016	$2 million
2017	$2 million
2018	Same as the federal transfer tax exemption

D.C. law does not recognize portability of the unused estate tax exemption between spouses. Nor does D.C. law recognize the use of a D.C.-specific QTIP marital trust.

Selection of Financial Fiduciary: Executor, Trustee, Agent under Power of Attorney

We cannot stress with too much emphasis the thoughtful consideration which should be given to the nomination of an appropriate party (or parties) to serve as executor under the will to administer a decedent's estate, to serve as successor trustee under a revocable trust upon death or incapacity of the settlor or settlor's spouse, to serve as trustee of an irrevocable trust for children, grandchildren or other family members, to serve as testamentary trustee under a will or trust for same, and to serve as agent under a power of attorney. We refer to these as financial fiduciaries.

Frankly our firm sees and hears of a great deal of bad or careless behavior by individuals serving as financial fiduciaries.

Should you consider naming a bank or trust company as your financial fiduciary, particularly as trustee of any trust for your benefit upon your own incapacity, or for your spouse and/or descendants after your death? Here is what we like about banks and trust companies:

- they are neutral, they have no conflicts of interest.
- they are professional.
- they are accountable, have deep pockets to correct mistakes, your family will not be bashful about suing them for bad behavior.
- they will not make stupid investments, they will diversify, they are bound by the Uniform Prudent Investor Act.
- they will not forget to file tax returns or to account in writing to the beneficiaries.
- they will not steal or "borrow" trust funds.
- their fees are known, published, on file with and approved by the state banking commissioner (generally about 1.1% of assets under management per year at $3 million, declining for larger amounts). And for that fee the bank or trust company will manage the assets, prepare and file all tax returns, and prepare and submit accountings of all amounts received and disbursed.

When our clients decide to appoint banks or trust companies, we always recommend:

- having a family member or trusted friend serve as co-trustee for the "human touch" in dealing with the beneficiaries.
- authorizing the individual co-trustee or other family members to discharge and replace the bank or trust company, but requiring the appointment of another bank or trust company (or maybe an attorney or accountant experienced with trusts) as replacement "independent" trustee.

Consider that if you name an individual as trustee, he or she will be expected to engage the services of an investment manager, who will charge approximately1% of assets under management at $3 million. And the individual trustee will likely engage the services of an accountant to prepare tax returns and possibly trust accounts. And an individual trustee with significant investment and administrative responsibilities may charge a substantial trustee fee, so that the fee of an individual trustee, when aggregated with the fees of the investment manager and accountant he or she selects, may exceed what a bank or trust company would charge to perform all of these functions.

Financial, Tax and Asset Protection Planning with IRAs

Many of our clients have or will have (as a result of future rollover of 401(k) plans) very large IRAs, frequently over $1 million. There are several complicated considerations in dealing with IRAs.

Asset Protection Planning: While the US Supreme Court has ruled in Patterson v. Shumate that creditors of a plan participant may NOT attach ERISA plans such as 401(k) plans, IRAs are not ERISA plans. Federal bankruptcy law protects from creditors in bankruptcy up to $1 million (indexed for inflation) in IRAs, but any amount held in IRAs by a beneficiary above the $1 million (aggregating all IRAs) may be accessible to creditors, depending on the exemptions from creditor claims afforded by the state law of the beneficiary's domicile. The laws of some states fully exempt

IRA plans. In Virginia, IRAs are "exempt from creditor process to the same extent permitted under federal bankruptcy law." In Maryland and DC, subject to some further limitations, IRAs are fully protected from claims of creditors.

Planning Idea: If you have any concerns about future creditors and have the option (e.g., upon leaving a job) to keep assets in a 401(k) plan or roll them into a new 401(k) plan with a new employer, leave them (or roll them) where they have unlimited protection – 401(k) plan accounts – rather than rolling them out into an IRA, in which they may have limited protection.

Inherited IRAs: What about death beneficiaries of IRAs? Are the IRA assets protected from creditors of beneficiaries who have inherited IRAs? No, there is no protection for non-spouse beneficiaries of inherited IRAs according to a recent U.S. Supreme Court decision in Clark v. Rameker (2014.)

How to Handle IRA Beneficiary Designation (at Death)

What is best way to handle death beneficiary designations on an IRA?

If Married: Because of the favorable income tax treatment accorded to a surviving spouse, it is frequently desirable to name the surviving spouse as beneficiary (although this is not required as it is with an ERISA Plan such as a 401(k)). The surviving spouse may roll over her husband's IRA into her own existing or new IRA with no income tax, leave it alone and let it grow and accumulate tax-free until she reaches the age of 70½, and then slowly withdraw only the required minimum distribution (RMD) to minimize annual income tax on the portion withdrawn, meanwhile letting the balance continue to grow and accumulate tax free.

QTIP Marital Trust for an IRA: If, for example, a spouse with children of a previous marriage wishes to put the IRA in trust for a surviving spouse but allow for the possibility that a remainder may pass to his children, he may by very elaborate beneficiary designation direct the IRA to a specially drafted QTIP trust in his estate planning documents which accommodates both the RMD and estate tax requirements.

If Unmarried or if IRA Passes to Children or Others: If a non-spouse is named as an individual beneficiary, the IRA maybe treated as an "inherited IRA" and the beneficiary may make an election to withdraw it as slowly as possible over the beneficiary's life expectancy (creating a so-called "stretch IRA"). Under this scenario the principal held in the IRA continues to appreciate tax-free even as the minimum distributions required are taxed to the beneficiary. But under Clark v. Rameker, creditors of a beneficiary of an inherited IRA may be able to attach the IRA principal. A possible solution is available to the initial IRA owner if creditors of the prospective beneficiary are anticipated: a "stand alone" retirement trust may be established and named as beneficiary of the IRA in lieu of naming the individual with anticipated creditors as beneficiary.

President Obama's Transfer Tax Proposals

President Obama's proposed 2016 budget includes several major changes to the current transfer tax regime. While it is virtually certain that none of them will become law in the next two

years, some or all of them may well be re-introduced if the Democrats retain control of the Presidency and retake one or both houses of Congress in the 2016 elections. The most important of these changes are briefly summarized below.

Arguably the most significant change from our current transfer tax regime would be the imposition of capital gains taxes on the transfer of appreciated assets at death (even if those assets are not sold by the heirs), with a modest $100,000 exemption designed to prevent the tax from affecting small estates. Currently, inherited assets receive a new "stepped-up" income tax basis to their date of death values.

The President also proposes reducing the estate tax exemption to $3.5 million (from the current level of $5.43 million, indexed annually for inflation) and increasing the top estate tax rate to 45% (from the current level of 40%). Moreover, he would "de-unify" the estate and gift tax exemptions. Currently, the entire $5.43 million exempt amount is available to shelter transfers during life or at death or any combination thereof. The President's plan would permit gifts of only up to $1 million during life without the imposition of gift tax. This proposal would, in effect, restore the transfer tax regime as it existed in 2009.

Other proposals in the transfer tax arena include the following: (1) limiting the duration of trusts exempt from the generation-skipping transfer tax (currently such trusts may have an unlimited duration in the many US jurisdictions that have eliminated the Rule Against Perpetuities); and (2) limiting the availability of the annual exclusion for certain transfers to trusts, LLCs and Family Limited Partnerships (FLPs) by imposing a new $50,000 overall limit on such gifts (currently each donor may give up to $14,000 per calendar year to any number of donees with no transfer tax consequences).

Those in a position to do so may wish to consider current gifts of up to the current $5.43 estate tax exempt amount to perpetual trusts for the benefit of their children and subsequent generations of their descendants. Even if the gift and estate tax exemptions are reduced, or the tax advantages of perpetual trusts are eliminated, or both, it is likely that existing arrangements would be grandfathered.

President Obama's Retirement Plan Proposals

The President's budget plan also contains a number of proposals which would affect retirement accounts. Like the transfer tax proposals summarized above, these have little chance of passage in the near future (and it may be difficult or impossible to plan around them). One of the most significant would prohibit additional contributions to retirement plans once an established cap (calculated by determining the lump sum needed to produce a joint and survivor annuity of $210,000 per year beginning at age 62, about $3.4 million in today's dollars) is reached. Other proposals which may be of interest include: (1) eliminating the special tax break for net unrealized income (which allows tax on retirement savings invested in the appreciated stock of one's employer or former employer to be paid at long-term capital gains rates under certain circumstances); (2) allowing Roth IRA conversions only for pre-tax (as opposed to after-tax) funds in a traditional IRA or employer-sponsored retirement plan; (3) imposing required minimum distributions (RMDs) on Roth IRAs in the same way they are imposed on traditional IRAs; (4) eliminating RMDs for individuals who have

a total of $100,000 or less in all of their tax-favored retirement accounts; (5) capping the maximum tax benefit for retirement plan contributions at 28% (so that taxpayers in income tax brackets higher than 28% would not receive a full deduction for their retirement plan contributions); and (6) requiring non-spouse beneficiaries of retirement accounts to withdraw those accounts within five years after the participant's death, eliminating so-called "stretch IRAs."

Planning Techniques for a Low Interest Rate Climate

For some time now we have been experiencing historically low interest rates. While this climate persists, it is a favorable time to employ sophisticated gifting techniques such as Grantor Retained Annuity Trusts (GRATs) and Charitable Lead Annuity Trusts (CLATs) which are most advantageous when the §7520 rate (an interest rate published each month by the IRS which is used to value annuity and remainder interests, etc.) is low. The §7520 rate for March 2015 is 1.8%. Moreover, one can make loans or installment sales to family members at extremely low rates without causing those loans or sales to be treated as partial gifts because the applicable federal rates ("AFRs") also published monthly by the IRS are so low. In March 2015, a short-term loan (less than three years) may bear an interest rate as low as 0.4%, a mid-term loan (between three and nine years), 1.47%, and a long-term loan (more than nine years), 2.19%. These low AFRs also make techniques such as loans or installment sales to Intentionally Defective Grantor Trusts (IDGTs) especially favorable right now. (An IDGT is a trust that is excluded from the grantor's estate for transfer tax purposes but structured so that the grantor is treated as the "owner" of the trust's income for income tax purposes. Transactions between a grantor and his grantor trust, such as loans and installment sales, have no income tax consequences for the grantor or the trust.) Interest rates are certain to rise again in the future, so anyone considering intra-family loans or gifting techniques such as GRATs, CLATs and IDGTs should act soon to take advantage of today's low rates.

Purchasing a Home While Maintaining Confidentiality

In the current social, political, and economic environment, many of our clients are increasingly concerned with confidentiality. Clients do not want the nature of and extent of their assets on the public record, and they are not comfortable with their home addresses and other contact information being so accessible to the public, especially on the internet. Of particular concern to many of our clients is the public disclosure of home purchases. When an individual or married couple purchases a home in his or her or their individual names, the deed disclosing the purchaser's identity is filed on the public record. In addition, when higher valued homes are purchased, these transactions often show up in Washingtonian magazine or in reports of sales in newspapers or other publications. There are many reasons clients may want to maintain confidentiality of the purchase of their home: public figures and higher net-worth clients do not want the public knowing where they live or what they paid for their home; others may have particular concerns due to their occupation or professional training; some may have personal or family legacy matters that mandate privacy. To meet our clients' increasing demands for confidentiality, our firm has developed a technique that allows our clients to purchase homes while preserving their confidentiality. A simplistic description of our approach is that we draft revocable trusts with a generic name to take title to the home, and Fred serves as the Trustee. Fred appears as the owner since he is the Trustee, and this is not newsworthy, so it does not get reported. And the revocable trust is not recorded on the public record anywhere. This trust is coordinated with the clients' other estate planning documents. This type of transaction often requires

extensive interaction with the mortgage lender, and we have successfully worked with many local and national institutions on this type of transaction. If you wish to explore this concept further, we encourage you to reach out to us.

Upcoming: Huge Wealth Transfer

It has been projected that over the next three decades $16 trillion worth of wealth will pass to younger generation family members in high net worth families - the biggest such transfer in history. The United States will see the lion's share of these transfers: some $6 trillion in the next thirty years.

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.

OTHER NEWS

Brooke is finishing up the first year of a two-year night school program at Georgetown Law leading to a Masters Degree in Tax Law (Tax LL.M.). The first year's courses are focused exclusively on estate planning, gift, estate and generation-skipping transfer tax, income taxation of trusts and estates, and international estate planning. The second year's program will cover corporate tax, partnership/LLC taxation, income tax accounting, and taxation of charitable and tax-exempt entities, among other areas. At the end of the first year, she will receive a Certificate in Estate Planning, and at the completion of her second year, she will receive the Masters Degree in Tax Law. In addition, Brooke was recently voted into the District of Columbia Estate Planning Council, an organization of lawyers, accountants, financial planners, insurance agents, and trust bankers involved in the estate planning arena. She is also a member of the Northern Virginia Estate Planning Council.

Fred spoke in Oklahoma City March 13th at a national asset protection planning conference for lawyers, focusing on Oklahoma's new Asset Preservation Trust Act. On June 24th Fred will be speaking to a conference of tax professionals of Baker Tilly, a national accounting firm, on domestic and offshore asset protection planning.

Our Firm was selected by US News and World Report as one of the Best Law Firms in the Washington Metro Area in 2015. Fred was named recently in Northern Virginia Magazine and in the November 2014 Washingtonian Magazine as one of the best Trust and Estate lawyers in the area. He was also named in 2015 as a Super Lawyer in Washington and Virginia and in Best Lawyers in America.

We have renewed our lease, so we will be staying put through at least October 31, 2019.

REVIEW OF YOUR SITUATION

If you would like us to review the desirability of any changes or additions to your estate plan or to discuss anything in this Newsletter, please contact us to set up an appointment.

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