Estate Planning Client Advisory

SUMMER 2010

As a valued client of this firm we are pleased to provide you our summer Estate Planning Client Advisory as a courtesy to keep you abreast of important tax and estate planning issues and opportunities.

The Estate Tax – An Uncertain Future Continues: Under President Bush's 2001 tax act the estate tax exemption was increased progressively from $1 million in 2001 to $3.5 million by 2009. But pursuant to Congressional budget rules the 2001 act expired on January 1, 2010 – leaving no estate tax liability for deaths in 2010 and with the estate tax slated to return on January 1, 2011 at the prior $1 million exemption.

Not surprisingly, the 2010 estate tax "holiday" has resulted in what some characterize as an unfair financial boon for families of wealthy individuals who died in 2010. Most notable among this group is Dan Duncan, a natural gas tycoon from Houston, who died of a brain hemorrhage in March at age 77. *Forbes* magazine estimated Duncan's net worth at $9 billion – making him the 74th wealthiest person in the world. Because Mr. Duncan died in 2010, his 4 children stand to inherit at least $4 billion more than if Mr. Duncan died a few months earlier or later.

Also, J. D. Salinger, author of *The Catcher in the Rye*, and New York Yankees owner, George Steinbrenner, both died in 2010 and their estates will pay no estate tax. *Forbes* magazine estimated Steinbrenner's net worth at $1.1 billion.

Earlier this year it appeared that positive estate tax reform was on the horizon, such as seen in the Treasury Department's 2011 revenue proposals issued in February and which presumed that the 2009 $3.5 million exemption would be made permanent in 2011. However, President Obama has recently indicated that he only supports tax cuts for the "middle class" and he has not shown support for increasing the estate tax exemption above the $1 million level.

However, Republicans and some centrist Democrats are considering extending all of the Bush tax cuts – at least until the economy stabilizes. And a recent *Wall Street Journal* article suggested that no significant tax legislation will be put forward until after the November elections so that incumbents can avoid alienating voters on both ends of the tax philosophy spectrum.

At this point what we do know is that the estate tax will spring to life on January 1st at the $1 million level if Congress fails to act – but whether Congress will act at all and, if so, what the estate tax law will be are uncertain. However, our very cautious prediction is that one of two scenarios are most likely. Either Congress will allow the estate tax to revert to a permanent $1 million exemption or Republicans will strike a deal with Democrats to enact estate tax reform in exchange for income tax increases or other legislative concessions.

In any event, much will turn on the outcome of the November elections and the campaign commitments the Congressional winners have made – as well as the national economy. Therefore, our recommendation is that those clients with potential estate tax concerns but who are in good health stay the course for the next few months until the estate tax dust settles and it becomes feasible to implement long-range estate tax planning.

Last Chance for "Super-Charged" GRATs Before Congressional Repeal?: One very useful lifetime technique to save estate taxes is the Grantor Retained Annuity Trust (or "GRAT"). A GRAT is a trust gifting format sanctioned by the IRS and under which a client transfers money, stock or other assets into a trust – the GRAT – and retains a set annuity payment from the GRAT for at least 2 years. After the annuity payments are made the GRAT expires and the balance of the GRAT funds pass to the client's heirs. Importantly, because the annuity payments to the client are not considered gifts, the GRAT annuity can even be structured large enough so that the heir's gift component value (the balance of the GRAT) has a $0 value for gift tax purposes. This type of GRAT is referred to as a Zeroed-Out GRAT because it is free of gift tax implications.

All that is necessary for the GRAT technique to "prevail" is that the total return on the GRAT assets during the term exceed the IRS interest rate for the month the GRAT is created (currently 2.6%) and that the client survive the GRAT term – and assets will remain in the GRAT to pass to heirs free of gift or estate tax implications.

For example, assume Dr. Miller, a 70 year-old man, creates a Zeroed-Out GRAT with $2 million. Assuming a 10% annual rate of return the GRAT will pass almost $250,000 tax-free to his heirs in 2 years. If instead Dr. Miller did not implement the GRAT but held the $250,000 until his death, the $250,000 would be depleted by approximately $125,000 in estate taxes before passing to his heirs at his death.

Unfortunately for taxpayers, on March 24th the House passed a Bill to eliminate the Zeroed-Out GRAT. As of this writing the Bill is with the Senate but no action has yet been taken. Therefore, for clients interested in implementing a Zeroed-Out GRAT now is the time to immediately move forward before Congress permanently eliminates this opportunity.

Roth IRA Opportunity to Expire on January 1st: As many know, there is no longer an income cap on eligibility to convert a traditional IRA to a Roth IRA. Importantly, all growth and income of Roth IRA assets, as well as withdrawals, are free of income tax and there is no required minimum withdrawal beginning at 70½ as with a traditional IRA. However, for conversions occurring by December 31, 2010, the income tax owed upon the conversion may be paid in 50% shares with the 2011 and 2012 tax returns.

Also, many other types of retirement plans, such as 401(k)s, with proper planning, can be converted to a Roth IRA.

We encourage you to consult your financial advisor to determine whether a 2010 Roth IRA conversion is advisable.

Florida Tax Residents – Vigilance Still Critical for Snowbirds: The budget deficits of many states continue to increase – and states continue to respond by increasing income tax rates and/or pursuing tax revenue from seasonal residents who claim Florida tax residency.

For example, Illinois experienced a $501 million deficit increase in April alone due to low income tax revenue. And Pennsylvania's budget deficit increased by nearly 40% during April when income tax collections fell far below projections.

Also, state budget woes have resulted in at least 10 states implementing laws this year to either require new government employees to work longer before retiring at full pension or to increase penalties for early retirement.

A recent study sponsored by the New Jersey Chamber of Commerce analyzed the migration of tax residents in and out of New Jersey during the 5 year period ending in 2008. The study reported that there was a net outflow of $70 billion in wealth to other states. Not surprisingly, the study reported that Florida was among the top 3 destinations of choice for the New Jersey departures.

Interestingly, a *Wall Street Journal* article discussing the study noted that "residents of the Garden State are fleeing to greener pastures." And Chamber of Commerce Chairman Dennis Bone commented that it was "crystal clear that the state's tax policies [including a top income tax rate of 10.75% and a top estate tax rate of 16%] are resulting in a significant decline in the state's wealth."

We anticipate that northern state governments will continue to increase their efforts to attempt to collect resident income and death taxes from their wealthier former residents – particularly those who have a seasonal residence in the northern state but have not implemented and maintained a comprehensive Florida tax residency plan. If you have any questions in this regard, please feel free to contact us.

An Heiress' Estate Plan is Challenged: A recent case provides a good illustration that one's estate plan must be prepared with proper legal counsel and protocol, and kept current, so that it will withstand a judicial challenge by a "disappointed" heir.

Ms. Gail Posner died in March at age 67. For those not familiar with the illustrious Ms. Posner, she was the widow of corporate take-over artist Victor Posner and lived a very public and eccentric life with her chihuahua "Conchita" in Miami Beach. For example, Ms. Posner gave Conchita a $15,000 Cartier necklace as well as a Cadillac Escalade for the dog's weekly spa visits. And true to form, Ms. Posner bequeathed her estate in a most unusual fashion.

Although Ms. Posner did leave her sole child, Bret Carr, a $1 million bequest, she apparently was much fonder of Conchita and her household staff. In fact, Ms. Posner left her $8.3 million mansion and $3 million in trust for Conchita, as well as bequeathed a total of $25 million to her bodyguards, housekeepers and personal aides. Needless to say, Ms. Posner's son has filed suit to challenge the estate plan.

Regardless of the outcome of the Posner case, it serves as a good reminder to ensure that one's own estate plan is current and legally in order – especially if it contains "unusual" provisions – such as the disinheritance of a child or an unequal division of the estate among one's children.

Estate Paralegal Liz Katkin Joins Firm: We are pleased to announce that estate paralegal Elizabeth Katkin has recently joined our Trusts and Estates Department, increasing our Department to 3 full-time paralegals. Liz is an avid gardener and long-term Florida resident with 2 grown sons. Liz has been in the legal field for more than 20 years and worked most recently with the law firm of Cummings & Lockwood.

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