PROSKAUER ROSE LLP®

Personal Planning Strategies

A report for clients and friends of the firm

December 2007

In this issue:

January 2008 Update – Federal and State Estate, Gift and GST Tax Changes

Federal Estate and GST Tax Changes

As we reported in our earlier issues of *Personal Planning Strategies*, the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Act") made significant changes to the federal estate, gift and generation-skipping Transfer ("GST") taxes.

In 2008, the top federal estate and gift tax rates remain at 45%. The federal estate and GST tax exemptions remain at $2 million.

2008 Gifts

In 2008, the gift tax exemption remains at $1 million and the gift tax annual exclusion remains at $12,000 ($24,000 in the case of a married couple). For gifts made to a spouse who is not a citizen of the United States, the gift tax annual exclusion increases from $125,000 in 2007 to $128,000 in 2008 (unlimited gifts are allowed between spouses when both are U.S. citizens). If you are planning to make annual exclusion gifts in 2008, you should consider making these gifts early in the year. Making a gift early in the year, of property that is likely to increase in value, has the advantage of increasing the amount of appreciation you can eliminate from your estate and avoiding gift tax on any post-gift appreciation.

Calendar Year	Top Federal Estate and Gift Tax Rate	Federal Estate Tax Exemption	Federal GST Tax Exemption	Federal Gift Tax Exemption
2008	45%	$2 million	$2 million	$1 million
2009	45%	$3.5 million	$3.5 million	$1 million
2010	Gift Tax Rate Equals Top Individual Income Tax Rate	Estate Tax Repealed	GST Tax Repealed	$1 million
2011	55%	Estate Tax Returns With $1 Million Exemption	GST Tax Returns With $1,060,000 Exemption Plus Inflation Adjustment	$1 million

2007 Gift Tax Returns

Gift tax returns for gifts made in 2007 are due on April 15, 2008. It is possible to extend the due date to October 15, 2008. As a reminder, if you created a trust in 2007, you should direct your accountant to elect to have your GST tax exemption allocated (or not allocated, as the case may be) to contributions to that trust. This is very important and should not be overlooked. You should call one of our attorneys if you have any questions about your GST tax exemption allocation.

"Crummey" Letters

If you transfer funds to an insurance trust (or another trust where a beneficiary has withdrawal powers), remember that when you make contributions to that trust, the Trustees should send "Crummey" letters to the beneficiaries to notify them of their withdrawal rights over those contributions. For example, if you contribute money to your insurance trust to pay your insurance premiums, the Trustees should send "Crummey" letters to the trust's beneficiaries to notify them of their withdrawal rights over the amount of your contribution to the trust. Without these letters, transfers to the trust will not qualify for the gift tax annual exclusion.

Summary of Rates and Exemptions

The table above summarizes changes in the federal estate, gift, and GST taxes from 2008 through 2010, when the estate tax is scheduled for repeal (before being reinstated in 2011).

Most estate planning commentators think that it is unlikely that Congress will take any action to reform the estate tax in 2008 due to the upcoming presidential elections. However, Congress is likely to pass legislation after the next president takes office so that the estate tax is not repealed in 2010, but is reformed with exemptions and tax rates at least equal to the amounts that will come into effect in 2009, as set forth above.

State Estate Taxes

In 2008, certain states, including California and Florida, continue not to impose a state estate tax. Other states, including New York, Massachusetts, and New Jersey, continue *to* impose a state estate tax. Connecticut imposes a state estate tax on Connecticut taxable estates that are more than $2,000,000. In 2008, the combined top federal and New York estate tax rate remains at 53.80%.

State	Top State Estate Tax Rate	Maximum Federal Exemption for 2008 Allowable by States	Federal Estate Tax Exemption for 2008
California	0%	N/A	$ 2,000,000
Connecticut	16%	N/A	$ 2,000,000
Florida	0%	N/A	$ 2,000,000
Massachusetts	16%	$ 1,000,000	$ 2,000,000
New Jersey	16%	$ 675,000	$ 2,000,000
New York	16%	$ 1,000,000	$ 2,000,000

As illustrated in the following charts, the estate of a decedent dying in 2008 with a $2 million estate would pay no federal estate tax, since the federal estate tax exemption is $2 million. If the decedent were a resident of California, Connecticut, or Florida, his or her estate would not pay state estate tax either.

Year of Death	Value of Gross Estate	Federal Estate Tax	California Estate Tax	Connecticut Estate Tax	Florida Estate Tax
2008	$2,000,000	$0	$0	$0	$0

However, if the decedent were a resident of Massachusetts, New York, or New Jersey, his or her estate would have to pay a $99,600 state estate tax since those states do not conform to the federal changes. Therefore, whether or not a state follows the federal estate tax changes introduced by the Act can affect the total amount of estate taxes due.

Year of Death	Value of Gross Estate	Federal Estate Tax	Massachusetts Estate Tax	New York Estate Tax	New Jersey Estate Tax
2008	$2,000,000	$0	$99,600	$99,600	$99,600

The amount of state estate taxes due becomes substantial in large estates. In 2008, the estate of a decedent with a taxable estate of $15 million will pay federal and state estate taxes totaling $6,876,740 if the decedent were domiciled in Massachusetts, New Jersey, or New York (and $6,877,180 if the decedent were domiciled in Connecticut), but only $5,850,000 if the decedent were domiciled in California or Florida.

Accordingly, individuals with a residence in Connecticut, Massachusetts, New Jersey, or New York and a second residence in California or Florida, should consider establishing their primary residence in California or Florida.

How Can You Avoid Death Taxes in a State Where You Are Not Domiciled?

If the determination is made that there will be death taxes owed to a state where real or tangible personal property is owned (*i.e.*, a state other than the state in which you reside), there are steps that can be taken to eliminate tax in such state.

Since only real or tangible personal property (*i.e.*, residences, furnishings, boats, etc.) is subject to death taxes in the state where the property is located, converting those assets into intangible assets should avoid the state death taxes in those states. Therefore, you may consider transferring out-of-state assets to a partnership, limited liability company (LLC), or corporation and retaining an interest in the entity as a partner, member, or shareholder. For example, if you are a Florida resident who owns a second home in New York, you can transfer your New York home to an LLC and retain ownership of that new LLC. Upon your death, your estate only owns an interest in an LLC, which is an intangible asset, and thus not subject to New York estate tax. It is important that a transfer to an LLC is not deemed a nominee or sham that could be disregarded. Accordingly, it is important to consult a qualified attorney in the jurisdiction in which the property is located before making any transfers.

If you have questions pertaining to a particular state's death tax regime and how ownership of property in such state may affect your estate plan and potential death taxes, please do not hesitate to contact us.

Why You Should Consider a Revocable Trust

Revocable trusts (sometimes called "living" trusts), can be useful tools for avoiding probate and other administrative burdens involving the Probate or Surrogate's Court, planning for incapacity, and maintaining privacy. While revocable trusts are not the answer for every client, they are worthy of consideration by most.

What Are Revocable Trusts?

Revocable trusts are established during the lifetime of the creator, also referred to as the Settlor, Grantor, or Trustor, for his or her own benefit. The Settlor, during his or her lifetime, retains the right to the income and principal of the trust and the right to amend or revoke the trust. Typically, the Settlor will act as the sole initial trustee of the trust, so that he or she has complete control over the assets of the trust. However, the Settlor may appoint one or more other persons to act as trustees, either with the Settlor or on their own. In addition, the Settlor may designate one or more successor trustees to act in the event of the Settlor's incapacity or death. These additional trustees may be relatives, unrelated individuals, banks or trust companies. When the Settlor dies, the trust becomes irrevocable, and the trust assets are disposed of as provided in the trust instrument, which becomes a substitute for a traditional will.

Assets of the Settlor are not governed by the terms of the trust until they are formally transferred to it. This can be accomplished during the Settlor's lifetime, or upon the Settlor's death, by use of a "pourover" will providing that any of the Settlor's assets not transferred to the trust by the Settlor during life shall be transferred to the trust at death. If you are domiciled in a state with a complicated probate process, you should consider transferring your assets to the trust during your lifetime.

It is important to know from the outset that your transfer of assets to a revocable trust, by itself, does not provide you with any estate tax savings. However, as is the case with a traditional will, a number of tax-specific provisions can be incorporated into the revocable trust to provide significant estate tax savings. For that reason, if you are considering creating a revocable trust you should confer with a qualified estate planning attorney.

Benefits of Revocable Trusts

Avoiding Probate

Possibly the greatest advantage of the revocable trust is avoiding probate or Surrogate's Court proceedings. Probate is the formal process whereby a judge oversees the administration and distribution of your estate. In some states, probate can be lengthy and costly. For example, the probate process in some counties in Florida and California can be complicated, and the corresponding legal and accounting fees can be significant.

In probate in some states, the distribution of the decedent's assets to his or her beneficiaries or heirs generally cannot occur until a waiting period has elapsed during which creditors may present claims against the estate. Estates may be required to file inventories listing and valuing all of the decedent's assets, as well as formal accountings describing in detail all of the estate's receipts and disbursements during administration. Furthermore, in some states, like California, it is necessary to obtain court approval before selling real estate owned by the decedent in his or her individual name.

The costs and delays of probate are avoided with respect to assets the Settlor transfers to his or her revocable trust prior to death. Probate must still occur for assets held in the Settlor's individual name at the time of his or her death. Where few assets remain in the decedent's individual name at his or her death, probate may be no more than a minor annoyance. That is because most states provide for a streamlined probate proceeding when the value of such assets is less than a certain threshold, and assets outside probate, including the revocable trust's assets, would be freely distributable without court supervision.

If you own real property in more than one state, a revocable trust may be particularly useful. In those circumstances probate would be necessary not only in your state of domicile, but an additional, or "ancillary" probate proceeding also is likely to be necessary in each other state where you own real property. Each ancillary proceeding would entail additional court costs and probably fees for local counsel. Those costs can be avoided if the real estate is transferred to your revocable trust prior to your death (the same thing may be able to be accomplished by transferring the real estate to a limited liability company, as discussed in our January 2008 Update article herein).

Courts in some states (but not Florida) require that people who would inherit your property if you die without a will (*i.e.* your relatives) be contacted and given the right to object to your Will before it is admitted to probate. If you do not have any close relatives and are leaving your estate to friends or charities, the delay and cost after your death of finding and notifying distant relatives may be significant. In such situations a funded revocable trust is usually recommended because there would be no need to contact anyone other than the beneficiaries receiving the property under your revocable trust at your death.

Ease of Appointing and Removing Trustees

In New York, New Jersey, and Connecticut, other administrative proceedings can be avoided by using a revocable trust instead of a traditional will. Although the probate process is not difficult in those states, if your Will creates trusts for your beneficiaries, those trusts are subject to court supervision. Each time a trustee is appointed, the appointment must be approved by the court. These proceedings may take months and cost thousands of dollars in legal fees. By contrast, appointment or removal of a Trustee under a revocable trust is accomplished by signing a simple document without any court intervention. Also, in Connecticut, the trustees of trusts created under wills are required to render an accounting to the court every three years. The delays and significant additional costs associated with this court supervision can be avoided by using a revocable trust. While the beneficiaries of the revocable trust would still be entitled to periodic accountings if requested, those accountings would not need to be approved by the court and could be prepared informally.

Planning for Incapacity

A revocable trust probably is the best way to provide for your potential incapacity. The terms of the trust instrument would designate one or more successor trustees to take over administration of the trust if you are unable to manage your own affairs (determined, perhaps, by the written opinion of two doctors). The trust would provide that, in that event, the successor trustees must use the trust funds for your benefit (and, perhaps, for the benefit of your family). A revocable trust, therefore, provides the comfort of knowing that, if you are incapacitated, your assets will be managed by persons you choose for you and your family.

Similar results can often be achieved with the use of a "durable" power of attorney, a relatively simple document which gives a family member or other agent the authority to conduct transactions on your behalf even if you become incapacitated. However, third parties such as banks and brokers often have more difficulty dealing with durable powers of attorney than with revocable trusts, and they do not always accept the agent's authority. Many financial institutions will not honor a durable power of attorney unless it is on their own form. Others will not honor them if they are more than six months or a year old. But in some states, such as New York and Florida, they are required to honor it.

If you become incapacitated and you have neither a revocable trust nor a durable power of attorney, it might be necessary for a court to appoint a conservator or guardian to manage your financial affairs. In many cases, this can be an expensive, lengthy, and potentially embarrassing proceeding. It may even result in the court appointing a stranger as the conservator or guardian if the court is not satisfied that any of your relatives may be suitable to act. Even after the conservator or guardian has been appointed, continued court supervision usually is required, which creates ongoing costs. In addition, the conservator or guardian typically is restricted from making other than the most conservative investments or from using your assets to benefit anyone other than you, such as your family.

Maintaining Privacy

Another advantage of a revocable trust is that, in the vast majority of states, the trust instrument, unlike a will, does not become part of the public record at your death. In general, no one other than the designated successor trustees and trust beneficiaries is entitled to see the trust. Therefore, using a revocable trust instead of a traditional will keeps private the manner in which you have chosen to leave your assets to your beneficiaries. Furthermore, as mentioned above, any assets that you transfer to the trust prior to your death do not become part of the probate proceeding. Accordingly, the size and nature of the trust assets would stay out of the public eye as well.

Sometimes banks and brokerage firms will require a copy of the trust to be submitted for review before opening an account in the trust's name. However, in recent years, most financial institutions, in lieu of requiring a complete copy of the trust, have begun accepting a limited number of pages of the trust (for instance, the first page and signature pages) or a "Certificate of Trust," in which the trustee confirms the validity of the trust and recites the trustee's powers under the trust instrument.

Transfers to Revocable Trusts During the Settlor's Lifetime

In the case of bank and brokerage accounts, transfers to the revocable trust are accomplished by simply retitling the accounts in the trust's name. The transfer of business interests, such as shares in a corporation or interests in a partnership or limited liability company, require the preparation of stock powers or assignment documents. For real estate, a deed should be prepared and recorded by an attorney in the state where the real estate is located. In the case of a cooperative apartment, permission from the co-op board must be obtained. As revocable trusts become more prevalent, some co-op boards have become willing to approve these transfers. In community property states like California, written consent of both spouses may be needed before certain property can be transferred to a revocable trust. While the transfer of assets to a revocable trust is rarely difficult, the financial consequences of each transfer should be analyzed by an attorney to ensure that the transfer does not cause any unforeseen transfer tax consequences.

Income Tax Implications

The creation of a revocable trust and transfer of assets to it does not trigger any income tax consequences. During your lifetime, no special taxpayer identification number is needed. You continue to report income on the trust assets and related deductions on your individual income tax return(s), as if you still owned those assets in your individual name.

Conclusion

Given its advantages, the revocable trust is a vehicle to be considered as part of almost any estate plan. Revocable trusts are not always the answer, but for most clients, they are the best way to minimize probate costs, plan for incapacity and maintain privacy. The benefits of a revocable trust may vary slightly depending on your state of domicile and the state(s) in which you own property. For that reason, when considering a revocable trust, it is important to consult with an attorney who is familiar with the laws of those jurisdictions.

Importance of Properly Maintaining a Family Limited Partnership

As we have advised our clients on previous occasions, the IRS scrutinizes family limited partnerships ("FLPS"), particularly upon a decedent's death in connection with an estate tax return audit. Although the IRS has taken an aggressive stance against FLPs, if properly structured and managed, FLPs continue to be an effective method to transfer wealth at a reduced transfer tax cost while offering many tax and non-tax advantages. It is still accurate to say that the IRS is routinely granting significant valuation discounts for FLPs.

In addition to reducing transfer taxes, FLPs have other important uses. A properly drafted FLP can create a layer of insulation between an individual and future creditors. It can also be used to transfer wealth to younger generations without divesting the parents' control over the portfolio. For an individual who owns real property in more than one state, a FLP can be used to avoid ancillary probate in the state where the real property is located, which otherwise may be required in addition to probate in the state of domicile. Additionally state estate taxes may be avoided from converting out-of-state real estate into a FLP, as discussed in more detail in our January 2008 Update article herein.

When our clients establish an FLP, we advise them how critical it is to respect the formalities of the FLP and maintain it in accordance with the terms of the partnership agreement and applicable law in order to obtain both the tax and non-tax advantages described above. For our clients who have FLPs, we want to remind them of the IRS' scrutiny and that it is critical to maintain their FLP properly. Poor administration of an FLP, such as commingling FLP and personal property, borrowing money from the FLP without arm's-length provisions, or failure to maintain partnership books and records, can jeopardize even a well drafted FLP. Because of the heightened scrutiny, many of our clients have asked us to assist them with the maintenance of their FLP. Please contact us if you would like our assistance.

Last Call For Lifetime Gifts To Charities From Individual Retirement Accounts?

As we reported in earlier issues of *Personal Planning Strategies*, the Pension Protection Act of 2006 included a provision that permits a person aged 70-1/2 or older to direct distributions directly from an Individual Retirement Plan ("IRA") of up to $100,000 per year to charity. However this provision expires at the end of 2007.

The benefit of making a direct distribution from an IRA to charity is that the IRA owner can exclude up to $100,000 of the distribution from his or her gross income, and such distributions are counted as part of their annual minimum required distributions. Because the IRA distribution is excluded from gross income, the IRA owner is not entitled to a charitable income tax deduction for the charitable gift. There are several technical requirements that must be met in order to ensure that the charitable IRA distribution will be excluded from gross income.

According to published reports, the Senate will be considering a two-year extension of the bill that allows for direct distributions from IRAs to charities at the beginning of December. The House passed a one-year extension on November 9th. However, despite lobbying from many charitable groups, it is uncertain whether this provision will be extended into 2008. Therefore, those who wish to take advantage of this opportunity should do so immediately. Please contact us if you would like our assistance in ensuring the gross income exclusion of your contribution to charity from your IRA.

You can also visit our Website at **www.proskauer.com**

BOCA RATON • BOSTON • LONDON
LOS ANGELES • NEW ORLEANS • NEW YORK • NEWARK
PARIS • SÃO PAULO • WASHINGTON, D.C.

Personal Planning Newsletter
Editor: Henry J. Leibowitz
Contributors: Jordana T. Berman and Scott L. Goldberger

Proskauer's Personal Planning Department includes attorneys with significant and diverse personal planning experiences. The following individuals serve as contact persons and would welcome any questions you might have.

Boca Raton

Elaine M. Bucher
561.995.4768 — ebucher@proskauer.com
Alyssa R. Feder
561.995.4771 — afeder@proskauer.com
Scott L. Goldberger
561.995.4742 — sgoldberger@proskauer.com
Albert W. Gortz
561.995.4700 — agortz@proskauer.com
Robert Jacobowitz
561.995.4742 — rjacobowitz@proskauer.com
George D. Karibjanian
561.995.4780 — gkaribjanian@proskauer.com
David Pratt
561.995.4777 — dpratt@proskauer.com
Jennifer E. Zakin
561.995.4767 — jzakin@proskauer.com

New York

Ilise S. Alba
212.969.3736 — ialba@proskauer.com
Jordana T. Berman
212.969.3749 — jberman@proskauer.com
Laura B. Greenberg
212.969.3199 — lgreenberg@proskauer.com
Henry J. Leibowitz
212.969.3602 — hleibowitz@proskauer.com
John F. Pokorny
212.969.3614 — jpokorny@proskauer.com
Lawrence J. Rothenberg
212.969.3615 — lrothenberg@proskauer.com
Lisa M. Stern
212.969.3968 — lstern@proskauer.com
Philip M. Susswein
212.969.3625 — psusswein@proskauer.com
Ivan Taback
212.969.3662 — itaback@proskauer.com
Jane C. Wang
212.969.3673 — jwang@proskauer.com
Jay D. Waxenberg
212.969.3606 — jwaxenberg@proskauer.com

Los Angeles

Mitchell M. Gaswirth
310.284.5693 — mgaswirth@proskauer.com

Proskauer Rose is an international law firm that handles a full spectrum of legal issues worldwide.

PROSKAUER ROSE LLP

Proskauer Rose is a leading international law firm, providing a wide range of legal services to clients worldwide.

To learn more about the Firm, visit www.proskauer.com.