Gray Plant Mooty Welcomes Two New Attorneys

Jacqueline M. Schuh joined Gray Plant Mooty’s Trust, Estate and Charitable Planning practice group in March 2008 and practices in our St. Cloud office. Jackie has 18 years of experience in estate planning, probate and related litigation. She also retired August 1, 2008 after a twenty-year military legal career as a Lieutenant Colonel (JAG) in the Minnesota National Guard.

Jessica B. Johnson joined the Trust, Estate, and Charitable Planning practice group on October 6, 2008 and is thrilled to be back in the Twin Cities after a year away. Jessica worked at Gray Plant Mooty while she was in law school, and returns to us after completing a one-year clerkship with the United States Tax Court in Washington, D.C.

Review Your Estate Plan Now: The Estate Tax Landscape Changes in 2009

If you have met with your estate planning attorney within the last eight years, you know that estate tax laws have been and remain unsettled. In 2001, Congress passed legislation intended to phase out estate taxes for a period of time. The amount that was exempt from federal estate taxes was ratcheted up from $675,000 in 2001 to $2 million in 2008. In 2009, the exemption amount increases to $3.5 million, which means that your estate plan might need some immediate attention. Unless Congress acts, the exemption will be unlimited in 2010, but will be only $1 million in 2011.

Many clients’ estate plans have been driven by tax-planning considerations. This is understandable given the high tax rate that can be imposed on an estate if normal estate planning techniques are ignored. Estate planners often recommend that clients reduce, avoid, or delay estate taxes by taking advantage of two estate planning concepts: (1) the estate tax exemption and (2) the unlimited marital deduction.

The Estate Tax Exemption and the Marital Deduction

The estate tax exemption is relatively easy for most clients to understand. Quite simply, every person has an exemption from estate taxes of $2 million (currently). This means that if you die owning less than $2 million, your estate will pay no federal tax, although Minnesota imposes an estate tax on amounts over $1 million. In January 2009, the federal estate tax exemption increases to $3.5 million. Therefore, for the purposes of this article, we assume that the federal estate tax exemption is and will remain $3.5 million.

If you own more than $3.5 million at your death, your estate may or may not owe federal estate tax, depending on the identity of the beneficiaries of your estate. First, your federal estate tax exemption shelters $3.5 million of the assets that you own at death from federal estate tax. Second, any assets that pass to a surviving spouse are also tax-free. This means that if you die owning less than $2 million, your estate will pay no federal estate tax, although Minnesota imposes an estate tax on amounts over $1 million. In January 2009, the federal estate tax exemption increases to $3.5 million. Therefore, for the purposes of this article, we assume that the federal estate tax exemption is and will remain $3.5 million.

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an outright or trust gift to children, or perhaps to children of a prior marriage, of the amount that is exempt from estate tax with the balance passing to a spouse or to charity. If your estate plan is structured that way and you signed your estate planning documents more than five years ago, the division of assets between those gifts could be much different than anticipated.

When the estate tax exemption amount was between $600,000 and $1 million, as was the case prior to 2003, the “maritalized plan” just described presumably made good sense both from the standpoint of overall taxes and as a reasonable division of assets between the surviving spouse and the family trust.

Now, with a $3.5 million exemption, the foregoing plan will have the effect of placing more property into the family trust and foregoing plan will have the effect of the surviving spouse and the family trust. As a reasonable division of assets between the “maritalized plan” just described when the estate tax exemption was $600,000, we would suggest that individuals review their estate planning documents. It may be appropriate to revise your estate plan in order to update the disposition of your estate or to avoid unintended consequences. And yes, in some cases, there may be opportunities to enhance your estate plan.

Gifts of Specific Dollar Amounts or Specific Assets
If your estate plan includes a gift to a beneficiary of a specific dollar amount, you may need to reconsider the size of that gift from time to time. Whenever a gift is made of a specific dollar amount, including a gift described by a formula such as the amount of the estate tax exemption, that gift will be taxable. The other gifts under the estate plan will be reduced accordingly. For example, Parent leaves $100,000 to his children. If the estate passes to the surviving spouse. At the time the estate plan was drafted, the gift to the children represented 10% of Parent’s estate. Now, because of the economic crisis the gift represents 25% of the value of the estate. Is a 25% split still appropriate? Will this leave enough assets for the spouse to live on? Should Parent revise his will so that the children receive 10% of the estate regardless of the dollar amount of that gift?

The result could occur where, for example, one spouse leaves insurance to his or her children by a prior marriage and the residue of the estate to a new spouse or to children of a second marriage. The insurance may remain relatively constant in value, but the assets passing to the second spouse or children of the second marriage may be diminished by the financial crisis. Similarly, if an IRA is left to charity to satisfy a pledge, the reduced value of the IRA may not completely satisfy that pledge and the balance would have to come from the other assets of the donor. This would reduce the amount passing to family members or other beneficiaries.

Division of Assets
For larger estates, estate planners typically recommend that each spouse should have individual ownership of assets having a value equal to the estate tax exemption in order to avoid wasting some or all of the tax exemption. With reduced values, one spouse may not have enough to accomplish this, while the other spouse may have more than enough assets. For example, John and Mary had an estate consisting of a house worth $1 million and securities, all in Mary’s name, worth $5 million. A few years ago, the estate planner recommended that John should have at least $2 million in his name alone. Following this recommendation, John and Mary transferred the residence to John. In addition, Mary gave John an additional $1 million in securities (on a tax free basis), leaving $4 million in Mary’s name alone. If the house value and the securities in John’s name have declined, he would not have enough assets to take full advantage of his exemption if he dies first. On the other hand, Mary’s assets would likely still exceed her exemption despite the decline in the market, thereby producing a tax at death.

Gifts
A down market also offers some estate planning advantages if you want to make lifetime gifts. Assuming an eventual financial recovery, a down market is an excellent time to make gifts to family members because the gift value would be low and the potential for appreciation may be great. For example, suppose John has a taxable estate. If he makes a gift of marketable securities currently worth $1 million (the lifetime gift exemption amount), there would be no gift tax to pay (assuming he has not previously made taxable gifts). If the market recovers by 20%, the amount of the appreciation (in the balance of the gifts) would pass to the family members tax free, saving close to $100,000 in taxes at John’s death.

What’s on the Line in 2009?
It is always good advice to review your estate plan when there are changes in the law, your family situation, or your financial situation. For many reasons, including the estate tax change coming in 2009, current market volatility, and the potential to give assets to the next generation at a lower tax cost, now is an ideal time to make sure your estate plan is up to date.

Pursuant to the rules of professional conduct set forth in Circular 236, as promulgated by the United States Department of the Treasury, unless we expressly state otherwise in this communication the word “advice” was intended or used to be used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Code of 1986, and it cannot be used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Code of 1986, and it cannot be used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Code of 1986.