ESTATE PLANNING

IDEAS TO HELP YOU PLAN FOR YOUR FUTURE

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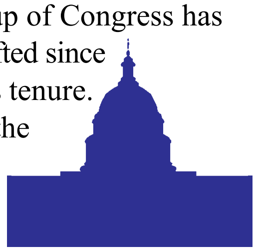
A NEW ADMINISTRATION IS IN WASHINGTON: NOW WHAT?

As 2010 approaches, we are nearing what many consider to be the best year in which to die. Why? Because in 2010 the estate tax is completely repealed. But the good news ends there. In 2011 the estate tax will come back with only a $1 million exemption. Or, maybe not.

In the first tax cut enacted by former President Bush, Congress approved increasing the federal estate tax exemption from $1 million up to $3.5 million in 2009, and the repeal of the tax in 2010. One reason many in Congress approved of this bold tax cut was because the repeal of the estate tax lasted only one year.

After last fall's election, the political make up of Congress has dramatically shifted since President Bush's tenure. On top of that, the government is in need of cash as our country faces the worst recession since the Great Depression.



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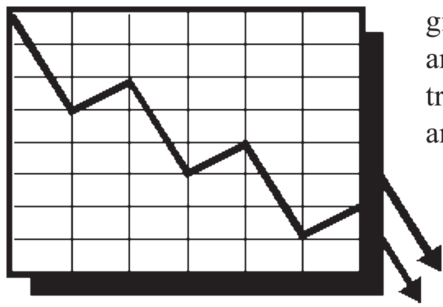
Given the current political landscape it is safe to say that the estate tax will remain for at least four, if not eight, more years.

Because of the uncertainty in the near future, I suggest that clients develop an estate plan based upon a $3.5 million federal estate tax exemption, but with some flexibility in case the exemption increases.

Married couples who properly plan can pass $7 million onto the next generation without any federal estate tax—$3.5 million per spouse. Since the combined state and federal estate tax brackets on amounts above $3.5 million can approach 51% or more, planning to maximize the use of the $3.5 million exemption in the estates of a husband and wife is imperative.

For individuals with estates worth $3.5 million or less, the higher exemption provides the chance to simplify estate plans. A few years ago, when the estate tax exemption was a mere $600,000, many Wills contained provisions that created a by-pass trust. The trust would hold the amount of the exemption so it would not be subject to estate tax in the estate of the surviving spouse. Now, if the combined estate of husband and wife is less than $3.5 million, such a trust is not necessary, and you can simply leave your entire estate to your spouse. This can make estate planning, and probate, much easier for families.

IT MAYBE THE WORST OF ECONOMIC TIMES BUT IT IS THE BEST OF TIMES FOR ESTATE PLANNING



None of us are happy about the current economic turmoil in the world, but it presents a unique opportunity for estate planning.

With the stock market depressed, gifts of stock may be made at little or no gift tax cost. When those stocks recover their market value, that appreciation will have taken place in the hands of the recipient of the gift, outside of your estate.

For example, if I give my children stock when the Dow is around $8,000, and later the market recovers and the Dow increases to $12,000, that 50% appreciation in the stock takes place outside of my estate and avoids estate tax.

Further, interest rates are at an all-time low. This provides an opportunity for you to make loans to your children or to trusts for their benefit at very low rates of interest. The trusts, or children, may invest that money in the depressed stock market, and the appreciation on those investments will take place outside of your estate.

In May 2009, the IRS-approved rate of interest on a loan for 2 years is only 9.8/10 of one percent—that is, .98%!! For loans of 3-9 years the rate is 3.325%, and for loans of longer than 9 years the rate is 5.24%.

You could create a trust for your descendants, seed it with a gift of stock or cash, and then loan the trust a significant amount of money for 20 years at 5.24%. So long as the assets in the trust exceed 10% of the loan, the trust would be excluded from your estate for estate tax purposes.

For instance, say that I wanted to loan $500,000 to a trust for my children. I would create the trust and seed it with $50,000. I would then loan the trust the $500,000 and take back a promissory note with interest at 5.24%. The note would pay me interest for 20 years, with the $500,000 payable at the end of the term. If the property in the trust appreciated at greater than 5.24%, all of that appreciation would escape estate tax at my passing. My estate would simply have the note for $500,000. This is often referred to as an "estate freeze" because the transaction freezes the value of the assets I loan to the trust.

If the trust contained "Grantor Trust" provisions, the income earned by the trust would be taxed on my income tax return. That means that my estate would be reduced by the income taxes on the trust's income, and the assets in the trust would compound tax-free.

A properly drawn Grantor Trust results in the Grantor being treated as owner of the trust assets for income tax purposes, but not for gift and estate tax purposes.

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Payment of interest to me on the promissory note would have no income tax impact to me or to the trust, since transactions I have with myself are not subject to income tax.

Even though I pay the income tax on the trust earnings, I am not considered to have made a gift of that tax money to the trust.

If I ever decide that the cost of paying the tax on the trust's income is becoming too expensive, the trustee can have the power in his discretion to reimburse me for the taxes.

If after 20 years the trust investments have not performed better than 5.24% per year, I am in no worse position than if I had done nothing. I get back my $500,000, or perhaps less. However, the likelihood of that happening is pretty remote.

The low interest rates also make Grantor Retained Annuity Trusts very attractive. Those are discussed in a separate article in this newsletter.

LOW INTEREST RATES DO HAVE SOME BENEFITS THEY ARE GREAT FOR GRATS

A Grantor Retained Annuity Trust (GRAT) is a trust which is designed to "freeze" the value of assets in a person's estate. The purpose of the trust is to transfer the appreciation in trust assets to family members at little or no gift tax cost.

To establish a GRAT, you execute a Grantor Retained Annuity Trust Agreement and fund the trust with assets. In the Trust Agreement you retain the right to receive an annuity from the trust for a period of years. The size of the annuity is often selected to equal what the return would be on the value of the assets used to fund the trust under the current IRS interest rate. If the return is actually greater than the IRS assumed interest rate, the excess return remains in the trust and goes to the family when the trust ends.

Due to the current world economic conditions, interest rates are at historic lows, and that presents a very significant planning opportunity for GRATs.

The best time to use a GRAT is when interest rates are low, since there is a possibility that over the term of the GRAT the investments in the GRAT will out-perform the current rate of interest.

Due to the current world economic conditions, interest rates are at historic lows, and this presents a very significant planning opportunity for GRATs.

For instance, assume you put $1,000,000 into a 5-year GRAT in July 2009, when the IRS assumed rate of return is 3.4%, and the GRAT provides that you are to be paid an annuity from the trust of $228,243 per year for the 5 years of the trust. Under the IRS actuarial tables, the present value of the annuity you will receive would equal the $1,000,000 which was put into the trust, and there would be no gift for gift or estate tax purposes.

However, if the assets put into the trust could appreciate at an average rate of 6% per year, at the end of the 5 years the assets remaining in the trust would be worth $51,600. That would be distributed to the family members at no tax cost. If the trust returned the historic stock market average rate of return of 10% per year, at the end of the 5 years $217,000 would be distributed to family members at no tax cost.

If the combined income and appreciation of the trust were 3.4% or less, there would be nothing left in the trust at the end of 5 years. There has been no cost, however, other than the expense of establishing the trust. Since there was no taxable gift when the trust was created, there would be no use of the gift and estate tax exemption.

If the Grantor dies during the term of the GRAT, what remains in the trust would be fully taxed in his or her estate. For this reason, it is preferable to keep the term of the GRAT relatively short.

Further, there is some possibility that during the term of a GRAT the stock market might have some downs as well as ups, and that those downs in later years could wipe out some of the ups from earlier years.

Therefore, you should consider creating cascading GRATs, which last for two years in duration. In that scheme, the distributions from the first GRAT fall into a second and third GRAT. If there are gains during the two years, those gains remain in the GRAT and pass to the family at the end of the GRAT.

On the other hand, if the investments in the GRAT go down in

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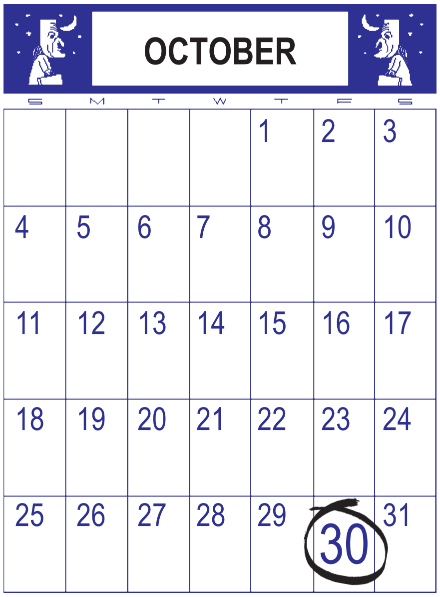
Peter J. Brevorka practices in New York and in North Carolina. He is also admitted to the Florida Bar, and is a member of the New York State Bar Association, North Carolina Bar Association, the Florida Bar, and the American Bar Association. He is a Fellow in the American College of Trust and Estate Counsel, and he is listed in *Best Lawyers in America.*

SAVE THE DATE



Peter will teach a continuing legal education seminar for the North Carolina Bar Association on October 30, 2009. The seminar will focus on Medicare planning for individuals entering nursing homes. Please contact our office for more information.

LOW INTEREST RATES DO HAVE SOME BENEFITS THEY ARE GREAT FOR GRATS

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value, the Grantor merely gets his stock back and starts a new GRAT.

Computing the actuarial value of the annuity to equal the initial contribution to the trust is called "zeroing out" a GRAT.

In the past, the IRS had taken the position that a GRAT could not be zeroed out. The IRS argued there was always some taxable gift because of the possibility of the Grantor dying during the term of the GRAT and having the whole trust taxed in his estate. The Tax Court ruled against the IRS on that issue, and the IRS acquiesced in that decision.

Among tax experts, however, there are rumors that the IRS may to have Congress pass legislation requiring valid GRATs to have a statistical 10% gift or have a 10-year duration. These requirements would make GRATs somewhat less attractive. Thus, if a GRAT sounds interesting, you should establish one in the near future in order to avoid any changes in the law.

OUR FIRM IS GROWING

Peter J. Brevorka, P.C., is pleased to announce that Jillian E. Brevorka has joined the firm as an associate attorney.

Jillian holds a Bachelor of Science degree from the Cornell School of Hotel Administration, and a Juris Doctor degree from the Wake Forest University School of Law. While at Wake Forest, she was awarded the American Bar Association and the Bureau of National Affairs Award for Excellence in the Study of Labor Law, and the CALI Excellence for the Future Award in Estate Planning and Labor Law.

Jillian is admitted to practice law in New York and North Carolina, and is currently preparing to take the Florida Bar Examination.

Jillian has decided to concentrate her practice in estates and trusts, and will be working in both the Greensboro and Western New York offices. She is pleased to join her father, Peter J. Brevorka, in the practice of law and she looks forward to serving the firm's clients.

Jillian E. Brevorka practices in New York and in North Carolina. She is a member of the New York State Bar Association, the North Carolina Bar Association, and the American Bar Association.