PUBLICATION

2009 Estate Planning Overview

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You are possibly among the many who have not updated their estate plans in recent years. A combination of the increase in the federal estate tax exemption over the past few years and the possibility that there may be no federal estate tax in 2010 has caused many people to develop a false sense of security. After all, shouldn't the significant increase in the exemption and the possibility of the tax's elimination mean that our estate plans need less attention?

The answer is a resounding "no."

Although the structure of the estate tax has not changed, it's likely that other factors have. Both positive and negative changes in your assets or your family situation may call for revision of your estate plan. Even the increase in the estate tax exemption may have an unintended impact. Individuals whose plans were designed to avoid or defer estate tax may now want to simplify those plans and avoid the creation of trusts that are no longer needed for tax purposes.

Important Non-Tax Reasons for Updating Your Estate Plan

Besides a desire to avoid estate and inheritance taxes, there are a myriad of other reasons for estate planning. If any of the following have occurred, you should consider modifications to your plan:

- Your marriage (with or without a prenuptial agreement). This may require the inclusion of particular testamentary provisions for a new spouse. In some states, marriage invalidates a former will.
- Your divorce. Be certain beneficiary designations are modified so that assets do not pass to an unintended beneficiary, such as an ex-spouse.
- Birth of a child or a grandchild. Consider specific bequests, § 529 college savings plans or establishing a trust.
- Marriage, divorce, or death of a child (or the former spouse of a child), particularly where such a person is named as an executor, personal representative, trustee, guardian, conservator, attorney-in-fact, health care proxy, or other type of fiduciary.
- Relocation or other change of circumstances of persons named as guardians for minors or as executors or trustees. Some states require that an executor be a resident of the state where probate will take place.
- Retirement or change in job that causes a change in employment benefits.
- Change in other family circumstances. Certain events may warrant changing testamentary provisions from outright disposition to disposition in trust. Factors indicating the need for a trust may include a lack of maturity or financial management skills, marital instability, concerns due to aging and potential senility, alcohol or substance abuse, and the preservation of government benefits or creditor concerns for beneficiaries who have special health needs. These same considerations might call into question the appointment of an executor, trustee, guardian or other fiduciary.
- Acquisition of new insurance. Assure the ownership and beneficiary designations coordinate to make an effective estate plan (i.e., consider whether the insurance should be acquired by a trust).
- Receipt or expected receipt of an inheritance. Consider the possibility of using disclaimers in order to minimize the impact of inheritance on your own estate.

- Acquisitions of a major asset such as a new home (i.e., consider how title should be held).
- Acquisition of a business interest and the implementation of buy-sell agreements.
- Sale or disposition of an asset that was specifically bequeathed in your Will. This may skew the apportionment among beneficiaries with unintended consequences.
- Creditor issues that may impact planning.
- Forced heirship rules.

Remember that proper estate planning should also include efforts to avoid conservatorship or interdiction and related problems in the event of incapacity – not just planning for what happens at death. The public drama surrounding end-of-life decisions in the Terri Schiavo case in 2005 should be a constant reminder of the importance of executing durable powers of attorney, powers of attorney for health care, living wills and advance health care directives. It is important that our loved ones know our wishes in the event of our incapacity.

Federal Estate Tax Changes

As you probably know, the federal estate tax exemption is $3.5 million for persons dying in 2009. As the law currently stands, the tax is set to be repealed in 2010, meaning that persons dying in 2010 can pass an unlimited amount tax-free. In 2011, however, the tax is set to be re-imposed with an exemption of only $1 million.

Congress has been debating a variety of "fixes" for this situation. Within the last few days, the House voted to extend the current $3.5 exemption on a permanent basis. However, the Senate has taken no action and there is no certainty that it will do so before the end of the year.

In the unlikely event that no legislation applicable to the estate tax becomes effective on January 1, 2010, different rules will apply to areas other than just that tax itself. For example, there may be a loss of the basis step-up currently applicable to property received from a decedent. Despite Congress' failure to produce legislation, we do not advise that clients put off estate planning that may be needed for non-tax reasons in order to "see what happens."

Gifts to Individuals

Currently, annual exclusion gifts not exceeding $13,000 per donee are exempt from federal gift tax. Gifts to trusts do not necessarily qualify for that exclusion, however. If your annual gifts include transfers to trusts, it is important to know to what extent the annual exclusion applies. It is also essential that trustees comply with any requirements in the trust document, such as giving beneficiaries timely notice of such transfers. Donors should also be aware that gift taxes may be imposed at the State level and that the State exclusion may not match the federal one.

Gifts to Charities

One current charitable giving incentive that is set to expire on December 31, 2009 is the IRA charitable roll-over. Under current law, any taxpayer who has reached 70 1/2 years of age may make tax-free distributions (a charitable rollover) of up to $100,000 from his or her IRA to most charitable, tax-exempt organizations (distributions made to supporting organizations or into a donor-advised fund do not qualify), provided that the distribution is otherwise eligible as a deductible charitable contribution (excluding applicable percentage limitations). These distributions are completely excluded from a taxpayer's gross income; therefore, there are no charitable deduction percentage limitation concerns for the distributions. The distributions must be made directly from the IRA trustee or custodian to the charity. Finally, the distributions can be considered part of an

IRA owner's required minimum distribution. A one-year extension of the charitable roll-over technique is included in pending tax legislation, but there is no certainty that it will pass by the end of this year, if at all. Therefore, if one wants to be certain to obtain the desired result, the roll-over transfer must take place by December 31, 2009.

Some State-Specific Issues

In this section we usually review specific issues that we consider significant from the States of Alabama, Georgia, Louisiana, Mississippi and Tennessee. Since our 2008 Estate Planning letter, there have been only a few recent developments that fall into that category, although due to the expansion of our D.C. office, we have added some news from that location. If your State is not mentioned, you should still feel free to contact us if you are concerned about the effect of legislation or a particular case in your State.

Tennessee:

Gap problem. Tennessee residents, as well as those in some other states, should be mindful of the so-called "gap" problem. This gap problem does not apply to residents of Alabama, Georgia, Louisiana and Mississippi, but could apply to any other state that has a separate inheritance or estate tax. The current federal estate tax exemption is $3.5 million, and there is currently a gap between the federal estate tax exemption and the exemption level available in gap states such as Tennessee. Tennessee's inheritance tax exemption is currently $1 million, meaning that no inheritance tax is due on estates with a value of less than $1 million. Accordingly, there is a $2.5 million gap between the federal and Tennessee exemption amounts. Formulas in estate planning instruments often need to be modified to avoid either paying a state inheritance tax on this gap amount and/or avoid wasting the amount of the federal exemption over the state exemption. If your estate instruments have not been reviewed in light of this potential "gap" trap, we suggest that you have your lawyer particularly review your estate planning instruments for this problem.

Tennessee Long-Term Care Partnership. On October 1, 2008, the Tennessee Long-Term Care Partnership became effective. It rewards Tennesseans for buying even a small long-term care insurance policy. With the purchase of a qualified long-term care policy, Medicaid becomes the payor of last resort, which means that individuals have more choices as to facility and services for long-term care, that individuals can keep a greater amount of assets even after applying for Medicaid, and that the State Medicaid budget saves money. Under the Partnership, a person who requests Medicaid payment of long-term care services after exhausting benefits under a long-term care policy may have certain assets "disregarded" equal to the benefits paid by the long-term care policy. These assets are not counted when a person's Medicaid eligibility is determined and will not be recovered during estate recovery when the person dies.

Alabama:

Changing Trusts. Alabama residents are finding increasing numbers of ways to utilize the relatively new (2007) Alabama Uniform Trust Code (AUTC). Using the provisions of the AUTC, it may be possible to amend or even terminate otherwise irrevocable trusts. Appropriate changes may include terminating a trust that no longer fulfills its intended purpose, combining two trusts into one or dividing a single trust into separate ones, changing trustees, or even changing trust beneficiaries.

Virginia:

Land Preservation Tax Credit. Virginia residents should be aware of 2009 legislation (H.B. 1891 and S.B. 510) that reduces from $100,000 to $50,000 per taxpayer the amount of Land Preservation Tax Credit (LPTC) that may be claimed on an income tax return. The LPTC is the Virginia complement to the Internal Revenue Code

§170(h), dealing with the charitable deduction for contributions of qualified conservation easements. The reduction is effective for taxable years beginning on and after January 1, 2009, but before January 1, 2011. The legislation also extends the carryover period from five years to seven years.

Conclusion

In conclusion, we suggest that you give your family one of the most important gifts possible – a well-planned estate. If any of the issues outlined above triggers a concern that you would like to discuss further, please contact any of the attorneys in our Tax Department.