Wealth Planning Update for Clients: Recent Changes and Upcoming Legislation

We would like to bring your attention to several important recent developments in the estate and gift tax laws that may affect you and your wealth planning strategies.

It Is Very Important to Consider a Family Partnership Now: A bill (HR 436) recently introduced in the House of Representatives would freeze the estate tax exemption at $3,500,000, freeze the maximum estate tax rate at 45% (50% for some estates over $10,000,000), and eliminate or reduce valuation discounts for transfers of interests in closely-held entities such as limited partnerships, limited liability companies, and corporations.

If this proposal becomes law, the bill provides that it will apply to transfers after the date of enactment. This means that any transfer where discounts are important, and where the transfer would be affected by the bill, must be completed before the date of enactment.

Because almost all family partnerships utilize some discounting for transfers, if you are considering the creation of a family partnership or making gifts of family partnership interests, you should undertake that planning now or risk losing the tax advantages if the aforementioned bill becomes law. If you think you may want to use this strategy, you should move forward promptly.

Regardless of HR 436, There Are New Rules in 2009: The federal estate tax exemption (the amount of assets that can pass estate tax free) increased from $2,000,000 to $3,500,000 for individuals dying on or after January 1, 2009. The federal gift tax exemption remains at $1,000,000, and the maximum estate and gift tax rate remains at 45%.

Under current law, if a person dies in 2010 there will be no estate tax, but for individuals dying in 2011 or after, the estate tax is reinstated with only a $1,000,000 exemption and a maximum estate and gift tax rate of 55%. Congress likely will enact legislation this year to avoid the current law's full repeal in 2010.

What This Means To You: If your estate plan includes a family trust or other bequest that equals your estate tax exemption, the amount that your trust or bequest will receive dramatically increased as of January 1, 2009. For individuals dying in 2009, the maximum amount that an exemption-matching trust or bequest will receive is now $3,500,000. Only a few years ago this amount was just $1,000,000.

One important consequence of this recent change is that your trust or bequest could receive **substantially more assets than you anticipated** at the time of your estate plan's creation, which in turn could leave far fewer assets available for distribution outside of the trust or bequest. Consider the following example:

> ***Example:*** *John A. Client has an estate of $4 million. John's Will, drafted in 2003, provides for an exemption-matching bequest to his children by a prior marriage, with the balance of his property passing to his spouse, Jane. If John had died on or before December 31, 2008, his children would have received $2 million, while his wife, Jane, would have received $2 million. If, on the other hand, John dies in 2009, his children will receive $3.5 million, while Jane will receive only $500,000.*

Further Effects of Recent Changes: If your estate (including the assets of your spouse if you are married) is under $3,500,000, you are no longer subject to the federal estate tax and may no longer need some or all of the tax planning provisions you have in your Will and other estate planning documents. For example, you may be able to reduce or eliminate any life insurance that you hold (or that is held in a life insurance trust) for purposes of funding estate taxes.

Lastly: As a reminder, the federal gift tax annual exclusion increased from $12,000 to $13,000 at the beginning of 2009. The current low Section 7520 rate (2.4% for March) and low valuations present a unique opportunity for higher net worth clients to transfer significant assets via intra-family loans, GRATs, and installment sales to grantor trusts at minimal transfer tax costs.

If you would like to discuss how these new developments may affect you, please contact:

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