



## **Be flexible!**

### **Estate planning for an uncertain future**

It's said that the only thing certain is change, and nowhere is this more true than in estate planning. Given the estate tax's uncertain future, it's more important than ever to build flexibility into your estate plan.

#### **The state of the estate tax**

During the last several years, exemption amounts have increased while tax rates have dropped. Under current law, the estate tax will disappear in 2010, only to reappear in 2011, when the exemptions and rates are scheduled to spring back to their 2001 levels. (See "Changing exemption amounts and tax rates".)

But lawmakers are expected to change the estate tax regime before 2010. Rather than keep the repeal in place, Congress may well preserve the estate tax but with a higher exemption amount (between \$3.5 million and \$5 million, for example).

#### **Be prepared**

With a range of possibilities — from no estate tax to the lowest exemption amount and highest tax rate in a decade — in mind, review your situation and explore techniques for building flexibility into your estate plan. The right approach depends on your particular circumstances, but here are a few strategies to consider:

**Give it away.** The simplest strategy is also one of the most effective. The annual gift tax exclusion allows you and your spouse to give up to \$12,000 each (adjusted annually for inflation) to an unlimited number of recipients free of gift tax and without using any of your lifetime gift tax exemption, currently \$1 million. So, for example, if you have three children and five grandchildren, you and your spouse jointly could make tax-free gifts to them of up to \$192,000 per year.

These gifts shrink the size of your estate, resulting in substantial savings in the event of an estate tax increase. But even if estate tax rates go down and the exemption amount goes up, a gifting strategy can't hurt.

You might even consider making gifts that exceed the annual exclusion amount and use up some or all of your \$1 million lifetime gift tax exemption. Although this reduces the size of your estate tax exemption down the road (assuming, of course, that the estate tax isn't repealed), you might be better off giving away certain assets now to remove any future income or appreciation in value from your estate.

**Just say no.** A qualified disclaimer is a refusal by a beneficiary to accept an interest in property. It's "qualified" if it's in writing, is delivered within a specified time period and meets certain other requirements. The disclaimed property then passes to a contingent beneficiary according to the terms of the will or trust.

If your estate plan is designed properly, your spouse or other beneficiaries can use qualified disclaimers to achieve the best tax results depending on the financial circumstances and applicable estate tax laws at the time. For example, Steve's estate plan provides for all of his wealth (\$5 million) to go to his wife, Aliza, but also provides that any amounts Aliza disclaims go into a bypass trust — also known as a credit shelter trust.

If all of Steve's assets go to Aliza, the unlimited marital deduction shelters them from estate taxes on his death, but his estate tax exemption is wasted. When Aliza dies, her estate will be subject to tax to the extent it exceeds her exemption amount.

If the exemption is \$3.5 million and the estate tax rate is 45%, for example, the estate tax on the \$5 million she inherited from Steve would be \$1.5 million x 45%, or \$675,000. Plus any appreciation on the \$5 million and any other assets in her estate also would be subject to the 45% estate tax.

A bypass trust, on the other hand, would provide Aliza with an income interest for life, after which the assets would go to her children or other beneficiaries. The trust assets would *bypass* her estate and use Steve's exemption to reduce or eliminate estate tax on them.

Steve's estate plan gives Aliza the flexibility to determine the best course when Steve dies. If, at that time, the estate tax exemption is \$3.5 million, she may want to disclaim \$3.5 million and allow it to go into a bypass trust, a strategy that takes advantage of both of their exemptions and avoids estate taxes.

On the other hand, if the estate tax has been repealed or the exemption amount has been increased to \$5 million, Aliza may want to accept the entire inheritance. Of course, if the estate tax is later reinstated or the exemption amount is lowered, Aliza's estate may be subject to estate tax.

**The GRAT escape.** A grantor-retained annuity trust (GRAT) allows you to remove substantial amounts of wealth from your estate, together with any future appreciation in value, while retaining an income stream. At the end of the trust term, the assets are transferred to your children or other beneficiaries tax-free.

There are a couple of disadvantages to this strategy. First, it works only if you outlive the trust term, so the term shouldn't be too long. Second, the initial contribution of assets to the trust is subject to gift tax if it exceeds your available gift tax exemption — an unnecessary expense if the estate tax is ultimately repealed or the exemption amount is increased beyond the size of your estate.

Fortunately, IRS regulations allow you to structure a GRAT in a way that minimizes (or, in some cases, eliminates) gift taxes.

### Revisit your plan

These are just a few examples of strategies you can use to build flexibility into your estate plan to make the most of any tax changes Congress devises. You should review your plan now to ensure it's ready for anything.

### Changing exemption amounts and tax rates

Year	Estate and GST tax exemptions <sup>1</sup>	Gift tax exemption	Highest estate and GST tax rate	Highest gift tax rate
2008	\$2 million	\$1 million	45%	45%
2009	\$3.5 million	\$1 million	45%	45%
2010	Repealed	\$1 million	N/A	35% <sup>2</sup>
2011	\$1 million <sup>3</sup>	\$1 million	55% <sup>4</sup>	55%

1 The estate tax exemption is reduced by any gift tax exemption used during your lifetime.

2 Equal to the highest marginal income tax rate, which is currently scheduled to be 35%.

3 GST tax exemption will be indexed for inflation.

4 The benefits of the graduated estate and gift tax rates and exemptions will be phased out for estates and gifts over \$10 million.

Source: U.S. Internal Revenue Code

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