

# PUBLICATION

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## Estate Planning: Reasons for Review

November 20, 2007

As we approach the holiday season, our focus naturally turns to our loved ones. Much time is spent reflecting upon our love and gratitude for friends and family and creating ways to express those feelings. At this special time of year, we encourage you to focus upon one of the most important ways you can express your love for family and friends -- giving the gift of a well-planned estate that saves them time, money, taxes and trouble in the event of your death or incapacity.

### Important Non-Tax Reasons for Updating Your Estate Plan:

Many clients believe that estate planning is only relevant to help them avoid estate and inheritance taxes; however, there are a myriad of other reasons for estate planning. For instance, 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.
- 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.
- Birth of a child or a grandchild. Consider specific bequests, § 529 college savings plans or establishing a trust.
- Divorce. Be certain that beneficiary designations are modified so that assets do not pass to an unintended beneficiary.
- 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.
- Change in 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.
- Retirement or change in job that causes a change in employment benefits.
- 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.

Please remember the 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 care directives. It is important that our loved ones know our wishes in the event of our incapacity.

**Federal Estate Tax Repeal:** You probably have heard of proposals to eliminate the federal estate tax, or raise the federal estate tax exemption so that few of us would need to worry about the 45% estate tax now imposed on estates over the current exemption amount. As you know, the efforts for a permanent cut to the estate tax have stalled during the last few years in Congress. Certainly, the future of the federal estate tax will be largely impacted by the upcoming elections in 2008.

The federal exemption is at \$2 million for 2007 and 2008, and will increase to \$3.5 million in 2009. The federal estate tax will be repealed in 2010, and then re-imposed in 2011 with a \$1 million exemption. In light of the uncertainty and Congress' inability so far to produce legislation, we do not advise that clients put off estate planning in order to "see what happens."

### **Gifts to Individuals and Charities:**

Currently, annual exclusion gifts that are exempt from federal gift tax are \$12,000 per donee. Congress recently enacted the Pension Protection Act of 2006 (the PPA), and President Bush signed it into law on August 17, 2006. The PPA is a massive tax bill that covers a multitude of issues, many of which, in keeping with the popular name of the PPA, relate to the overhaul of pensions (or defined benefit plans and other deferred compensation arrangements). In addition, however, the PPA includes a number of significant charitable giving incentives, as well as reforms aimed at certain types of exempt organizations and charitable giving practices.

The PPA's charitable giving incentives provide tax advantaged charitable giving opportunities. The PPA's reforms focus mainly on: (a) certain types of exempt organizations that have been targeted in the past few years for allegedly abusing their tax-exempt status, and (b) certain charitable giving practices that have likewise been perceived as abusive. Charitable giving incentives include:

- For tax years beginning on or after January 1, 2006, and concluding before January 1, 2008, a taxpayer who has reached 70.5 years of age may make tax-free distributions (a charitable rollover) of up to \$100,000 per year 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.
- The PPA extends favorable rules for charitable deduction of donations of certain food and book inventories through December 31, 2007.
- The PPA implements favorable basis adjustments for holders of S corporation stock making charitable contributions of appreciated property.

### **Some State-Specific Issues:**

#### **Tennessee**

Gap problem. Another reason for you to presently focus on estate planning is the so-called "gap" problem that exists in Tennessee and some other states. 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 \$2,000,000. There is currently a gap between the federal estate tax exemption and the exemption level available in gap states such as Tennessee. 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 Investment Services Act of 2007. An interesting new estate planning tool was recently created by virtue of the Tennessee Investment Services Act of 2007 (the TIS Act), which became effective July 1, 2007. The TIS Act attempts to provide protection from creditors by allowing the creation of self-settled, asset protection trusts referred to as "Investment Services Trusts" (IST). The IST must meet certain statutory requirements. In most instances, transfer to the IST cannot be attached by creditors unless the creditor makes a claim under the Uniform Fraudulent Conveyance Act. Creditors also cannot make claims against a trustee or any person involved in the counseling, drafting, preparation, execution and funding of the IST. We strongly caution you to consult with estate planning counsel so that you can more fully understand what these trusts are, the protection that they provide and any potential downside to the creation of such a trust.

## **Alabama**

Alabama Uniform Trust Code. The Alabama Uniform Trust Code (AUTC) became effective January 1, 2007. The AUTC allows the grantor and/or the beneficiaries to terminate or modify irrevocable trusts under certain circumstances. This is a significant departure from prior law. Clients and beneficiaries can now seek to terminate irrevocable trusts where the trust is no longer needed or desired. This gives considerable flexibility to rearrange aspects of an estate plan. Clients who do not want trusts for descendants or other individuals to be terminated after the client dies may add certain language to their Wills and trusts to prevent the beneficiaries from terminating a trust after the client's death. The AUTC also places a significant burden on trustees to disclose certain information regarding trusts to the beneficiaries. If a client wants such information to remain private until after his or her deaths, the disclosure requirements may be waived by a provision in the trust. Clients should consider whether or not to modify their Wills and/or trusts to waive this trustee disclosure requirement.

Uniform Estate Tax Apportionment Act. The Alabama Uniform Estate Tax Apportionment Act (ETAA) became effective on October 1, 2007 and applies generally to persons dying after December 31, 2007. The issue of estate tax apportionment concerns the source of payment of estate taxes and, thus, the beneficiaries who will bear the burden of the tax. Prior to the ETAA, Alabama law provided that estate tax was to be paid from the residue (i.e., the estate assets remaining after any specific bequests of cash, personal property, real estate, etc.) of an estate. While there are federal exceptions to this general rule (i.e., right of recovery for estate taxes attributable to certain marital trusts), the prior law sometimes caused inequitable or unintended results. For example, if a person received property by beneficiary designation, specific bequest or right of survivorship, he or she would not have to pay estate taxes on the property. Rather, the beneficiaries of the residuary estate had to pay the estate tax attributable to the jointly owned property. Under the ETAA, the apportionment rules apply if a testator does not make a provision in the Will regarding how estate taxes are to be apportioned. The ETAA rules will apportion the estate tax among the beneficiaries of the estate, essentially on the basis of their shares in the net taxable estate, which will include joint tenancy assets, retirement accounts and life insurance. This significant law may have substantial impact upon some clients' estate plans.

## **Louisiana**

Succession Opening Requirements. Years ago, the Louisiana legislature repealed the Louisiana inheritance tax for deaths occurring after June 30, 2004, as long as the succession was judicially opened within nine months of death. Louisiana recently removed the requirement that the succession be judicially opened within nine months of death; however, that repeal is not effective until January 1, 2008. Thus, for individuals dying before March 31, 2007, a succession must still be opened within nine months to avoid Louisiana inheritance tax. If Louisiana inheritance tax was paid by the estate of an individual dying after June 30, 2004 because the succession was not judicially opened within the nine month period, a claim for refund may be filed between August 1, 2008 and December 31, 2009.

Gift Tax Repeal. The Louisiana legislature also repealed the Louisiana gift tax for gifts made on or after July 1, 2008. A Louisiana taxpayer contemplating a large gift during 2008 may well consider waiting until July 1 to make such a gift in order to avoid Louisiana gift tax.

## **Georgia**

Advance Directives for Health Care. Effective July 1, 2007, the Official Code of Georgia was amended to provide for an "advance directive for health care," one document in which an individual can appoint an agent for health care decisions, declare preferences regarding end of life procedures, and name a choice for guardian if needed. The document replaces the traditional "living will" and durable power of attorney for health care.

On the Horizon. Proposed legislation to clarify, expand and modernize the Georgia Trust Code was presented to the Legislation Committee of the State Bar of Georgia to be considered for introduction in the 2008 Georgia General Assembly. This initiative includes provisions clarifying creditor rights against settlors of irrevocable and revocable trusts, automatically granting a wide range of powers to all trustees and expanding the description of trustee duties, allowing trusts to be reformed by Court action and allowing trusts for animals.

## **Mississippi**

Estate Tax Reminder. There are no Mississippi state estate taxes for decedents dying on or after January 1, 2005. The Mississippi state estate tax was tied to the federal state death tax credit which was repealed in 2005. If you have not already updated your estate planning documents to reflect this change in the law, please contact your estate planning professional.

Health Care Directives Update. The Mississippi statute providing for advance health-care directives was amended in 2005 to add part 4 which is an optional certificate of authorization for organ donation. The form allows individuals to donate specific organs for medical purposes. Again, please contact your estate planning professional to be sure your documents are up to date.

On the Horizon. Possible legislation that the Mississippi Legislature will consider next spring includes clarification of the Mississippi Estate Tax Apportionment Act, clarification of the conservatorship statutes, and a new durable power of attorney act.