

# MEMORANDUM

TO: Clients of Strauss & Associates, P.A.  
FROM: Strauss & Associates, P.A.  
RE: Expanded 2009 End of Year  
DATE: December 1, 2009

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For 2009, the estate tax exclusion amount is at a historic high of \$3.5 million, up from \$2 million in 2008, with a flat tax of 45% on the excess. As part of the tax reductions passed in 2001, however, the estate tax has been slated for a single year of full repeal in 2010. Further, the 2001 law was scheduled to expire in 2011 and return the estate tax with a top marginal rate of 55% and an applicable exclusion amount of only \$1 million. No one can predict with any certainty where the estate tax exemption will fall, but most practitioners believe it will be between \$1 million and \$3.5 million, however, no one can really predict what Congress will do with the estate tax laws.

## Review of Existing Wills and Living Trusts

### Potential Problem caused by repeal of estate tax

Though Congress might vote this week on extending the 2009 exemption into 2010, there is still the possibility there will be no estate tax in 2010. For married couples, repeal of the estate tax could cause uncertainty in how your plan works. If you have not restated your living trust since 2001, please contact us for a review.

### Credit Shelter Trusts – Could you be leaving your spouse far less than you intended?

Many Living Trusts (or wills) provide for “family trusts,” typically created to maximize the amount of assets passing free of estate tax on the surviving spouse’s death by taking advantage of the maximum federal exclusion. The increased federal exclusion amount may result in the creation of a Family Trust with up to \$3.5 million (or whatever the exemption ends up with) upon the death of the first spouse to die. Some clients with such planning in place may find that the size of the Family Trust substantially exceeds the amount originally anticipated, which could affect the surviving spouse’s access to resources.

Under these circumstances, formulae for smaller Family Trusts, designed to create trusts which will pass free of both federal and state estate taxes, may be worthy of consideration.

**Specific and “Cash” Bequests – Are you leaving large cash or property bequests that might result in other beneficiaries getting disinherited?**

The proportion of an estate represented by bequests made to family members, other persons or charitable organizations, if in the form of stated dollar amounts or of specific property, may have been altered by declining asset values. Whether such bequests continue to meet a client’s original objectives relative to the overall value of his or her estate should be re-considered.

**Estate Planning Techniques to consider now**

With an economic climate of declining asset valuations, reduced retirement savings, financial institutions facing difficulties and recession (or worse) dominating the news, lifetime transfers of assets to younger generations may seem to have a low priority. However, lower asset values combined with historically low interest rates present particularly attractive opportunities for transferring wealth.

**Grantor Retained Annuity Trust (“GRAT”) – Do you have assets with potential to appreciate in the next 2 – 5 years?**

This estate planning technique utilizes IRS-approved discount factors to make gifts of assets having the potential for appreciation with minimal or no gift tax consequences. In a GRAT, the client transfers property to an irrevocable trust, retaining the right to a fixed annuity for a term of years, and the value of the gift to the trust for gift tax purposes is reduced by the IRS-determined present value of the client’s retained interest. If the client survives the term of the trust, any property remaining in the trust, including any appreciation in the trust assets that exceeds the IRS-assumed rate of interest (which is 3.4% for September, 2009, and is recalculated monthly), passes to the client’s beneficiaries free of any gift or estate tax.

Obviously while some GRATs may appreciate and succeed, others may fail. A GRAT may currently be structured so as to “zero out” the taxable gift with an annuity set at a level so that the present value of the client’s retained interest is equal to the value of the property transferred to the trust. This approach allows the use of any number of GRATs, some of which are likely to succeed. There is some discussion that Congress may change the law to require that a gift to a GRAT have a value of greater than zero for gift tax purposes, therefore requiring the use of a portion of the client’s lifetime exclusion for

gifts (currently at \$1 million, beyond which gift tax would be payable) and discouraging the use of an unlimited number of GRATs. However, low interest rates, currently low asset values and favorable law make a GRAT a particularly attractive estate planning tool at this time.

**Qualified Personal Residence Trust (“QPRT”) – Would you like to remove the value of your home from your taxable estate without moving out?**

A silver lining of the cooling real estate market is the opportunity to use a QPRT to transfer a “personal residence” (e.g. your primary residence or your vacation home) to beneficiaries while values are low. In a QPRT, the client transfers a home to an irrevocable trust, retaining the right to reside in a home rent free for a fixed term of years. The amount of the taxable gift made upon the initial transfer of a home is the value of the residence, discounted by the IRS-determined present value of a client’s retained interest. If the client survives the term of the trust, the value of the home, including all appreciation after the creation of the trust, will be removed from the client’s taxable estate. After the trust term ends, a rental arrangement for the client’s continued use of the home can be structured, and rent payments from the client to the beneficiaries (which can be used to pay property taxes, insurance and other home expenses) can further reduce the client’s taxable estate. The trust can be extended and appropriate provisions included so that no income tax is payable by the beneficiaries on the rental income, thereby creating more tax savings.

**Non-Taxable Gifts – You may want to consider making gifts of assets that have reduced in value by the recession**

The annual exclusion for gift tax purposes has been increased to \$13,000 per donee (or \$26,000 for married couples who are “gift-splitting”). Annual exclusion gifts remain among the most advantageous estate planning opportunities as they remove from the client’s taxable estate not only the amounts of the gifts, but also any post-gift income and appreciation on the property. Such gifts could be utilized to transfer a family business or other interests that have declined in value. Gifts to pay tuition and medical expenses can be made in unlimited amounts if paid directly to the educational or medical institution. The special annual exclusion for gifts to non-citizen spouses has increased to \$133,000 for 2009, up from \$128,000.

**Life Insurance Trusts – Are you property rich and cash poor? Or do you want to increase your legacy to your family?**

Life insurance continues to be a uniquely favored asset for estate tax purposes. If insurance on a client’s life is acquired by a properly drafted and administered life insurance trust (or an existing policy is transferred to such a trust and the client survives

another three years), it is possible for the insurance proceeds to be excluded from the client's taxable estate. A life insurance trust is especially useful for a client who is property rich and cash poor, as it can provide the family with a cash flow to pay for estate taxes and administration expenses. Clients considering the purchase of significant life insurance policies, or already having them in place, may wish to consider creating life insurance trusts.

### **Limited Partnerships and LLCs – Do you want to pass business assets to your family in a structured way?**

The IRS continues to attack the discounted valuation of limited partnerships and LLCs, but taxpayers have had some court victories in 2008 and 2009. These cases are very fact-specific but have some common elements. To note a few, the discounted valuation of an entity is more likely to be respected if: there were legitimate non-tax purposes for forming the entity; there is an ability to document active management of the entity's assets; the client refrains from the use of an entity as a "pocketbook" for personal expenses; and sufficient assets are maintained outside the entity to provide for the client's support and the payment of estate taxes on the client's death. Clients with limited partnerships or LLCs in existence should ensure, in consultation with counsel and other advisors, that all necessary legal formalities (e.g., tax filings, periodic meetings, etc.) are being observed.

## **Retirement Plans**

Even after the recent economic downturn, taxpayers still hold nearly \$15 Trillion in IRAs and qualified plans, and much of this will be transferred to beneficiaries in the coming years. Making sure your retirement accounts are set up to meet your goals is critical.

### **Required Minimum Distributions – Suspended this year**

On December 23, 2008 President Bush signed the Worker, Retiree and Employer Recovery Act of 2008, which amends various statutes that govern pensions and other qualified retirement plans. Most notably, the Act suspends the application of the minimum distribution rules for 2009 as they apply to IRAs and "defined contribution plans" (such as 401(k) and profit sharing plans). With a few rare exceptions, owners of such accounts and the beneficiaries of deceased account owners will not be required to withdraw funds until 2010.

## **Non-Spousal Rollovers – Rule change for 401(k), 403(b) and other qualified plans**

It is now required that all qualified plans allow rollovers to IRAs not only for spouses who inherit such plans, but also for individual beneficiaries. Although not all of the benefits of spousal rollovers (such as the ability to designate subsequent beneficiaries over whose life expectancy distributions can be deferred) will be available, non-spousal rollovers increase the options for inherited retirement plans.

## **Roth Conversions – Starting in 2010, everyone can convert**

The \$100,000 income limitation on converting a retirement account to a Roth IRA is being eliminated on January 1, 2010. Every taxpayer with a retirement account should consider whether converting to a Roth IRA will benefit them or their family. Unlike traditional retirement accounts, a Roth IRA grows tax-free and does not require minimum distributions at 70 ½. We have specific analytical tools to help you decide whether a Roth conversion is right for you, and how to help maximize the benefits.

## **Creditor Protection for IRAs – Special planning can protect the account for your heirs**

Since IRAs are protected to at least some extent under state law, most clients and their advisors believe that these assets are similarly protected from the creditors of the beneficiary. To the contrary, there is a little-known yet alarming trend of courts finding no asset protection for inherited IRAs. Significantly, every court that has considered this issue, including courts in the two most debtor friendly states (Florida and Texas), have ruled that IRA beneficiaries have no asset protection for IRAs. And it is reasonable to assume that other jurisdictions will follow suit.

With trusts designed specifically for this purpose, your IRA beneficiary designations can be structured to provide asset protection for IRA beneficiaries and ensure that the beneficiary achieves maximum tax deferral.

## **General Housekeeping**

As always, we recommend a review of your estate plan whenever there is a significant change in your family situation, your financial circumstance or the tax law. We also continue to recommend the periodic review of all of your estate planning documents, including your living wills, health care proxies, powers of attorney, and beneficiary designations for life insurance policies and retirement plans. Periodic reviews of life insurance coverage are also recommended in appropriate circumstances to assess whether existing coverage is adequate.

We hope you find this information helpful. If you have any questions about any of these concepts or developments discussed in this letter, please contact us. If you are interested in a review/planning meeting, please call Bonnie Archer in Asheville at (828) 210-0511 or Joy Irwin in Hendersonville at (828) 696-1811 to schedule.

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