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Tax Law

ALERT

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Important 2009 New Year's Resolution: Review Your Estate Plan

The combination of declining asset values during 2008 and the increase in the estate tax exemption from $2,000,000 to $3,500,000 effective January 1, 2009 has created potential significant distortions in many estate plans. **These distortions can potentially undermine the surviving spouse's financial security and reduce the assets remaining under that spouse's unilateral control.** The examples below illustrate potential problems that may require prompt attention to modifying estate planning documents:

Example 1:

As of January 1, 2008, husband and wife's estate amounted to $10,000,000. The estate plan provides that an amount equal to the first spouse's estate tax exemption is to be allocated to the children, and the balance is to be allocated to the surviving spouse (or to a Marital Trust for the surviving spouse's benefit).

As of January 1, 2008, the distribution at the first spouse's death would have been $2,000,000 to the children and $8,000,000 to the surviving spouse (or to the Marital Trust).

As of January 1, 2009, the estate has declined in value to $6,000,000. Therefore, the distribution at the first spouse's death would be $3,500,000 to the children (due to the increased estate tax exemption), and only $2,500,000 to the surviving spouse (or to the Marital Trust). **The surviving spouse's share has been reduced from $8,000,000 to $2,500,000.**

Example 2:

Same assumptions, except that the estate plan provides for an amount equal to the deceased spouse's estate tax exemption to be allocated to a "Bypass Trust," which provides that discretionary payments of income and principal can be made to the surviving spouse and children for "reasonable support." At the surviving spouse's death, the Bypass Trust passes to the children. The remaining assets are allocated to the surviving spouse. Here again, $3,500,000 is allocated to the Bypass Trust in which the surviving spouse has only limited access to the funds. **The assets under the surviving spouse's unilateral control have been reduced from $8,000,000 to $2,500,000.**

Similar problems can occur in estate plans utilizing generation skipping transfer ("GST") trusts based on the applicable GST tax exemption. That exemption also increased from $2,000,000 to $3,500,000 as of January 1, 2009. Estate plans that allocate assets to GST Trusts based on the applicable GST tax exemption may cause unexpected distortions by dramatically reducing the assets passing outright to children.

The foregoing examples illustrate some of the potential effects of declining asset values and the increased estate and GST tax exemptions. We encourage you to contact your estate planning lawyer to review your estate plan and determine whether changes should be made.

For more information about any of the techniques and strategies discussed in this newsletter, or any other income or estate tax planning assistance, please feel free to contact any member of our High Net Worth Family Practice Group.

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