

The Guttenberg Press

Preserving Your Assets ... Planning Your Future

LAW OFFICES OF ARYEH GUTTENBERG • 1777 REISTERSTOWN ROAD • BALTIMORE MARYLAND 21208 • 410-484-7711

Fall 2002



Dear Frined:

hope you have had an enjoyable summer.

We are in a period of uncertainty with respect to estate planning. There have been major tax changes but the impact for the future is still unclear. That is because legislative endeavors are dependant upon the makeup of our country's political leadership as well as the economic climate.

But we have had over a year now to plan in this climate. In this issue as well as in future issues, I will address those strategic plans that we have empirically found to be highly effective for our clients since the advent of the new tax changes. One solution is the use of "disclaimer trust" which is addressed in this issue. These solutions need to be tailored for each client for optimal results. You should feel free to call to review these approaches.

On July 1, 2002, we celebrated our 10th Anniversary of our law practice in Pikesville. We are so thankful to you for your support, encouragement and well wishes.

Let's stay in touch!

New and Extraordinary Uses of Disclaimer Trusts for Flexibility, Asset Protection and Estate Tax Reduction

Under the 2001 tax legislation affecting estate and gift taxes, the lifetime estate tax exemption for each person increased to \$1 million in 2002 and 2003, and gradually to \$3.5 million by 2009. The estate tax is scheduled to be suspended in 2010 and reinstated with a \$1 million exemption in 2011 unless additional legislation is enacted before or at that time. This Congressional sleight of hand is akin to the pea in the huckster's shell game at carnivals -- now you see the estate tax, now you don't. But the real trick is to find creative opportunities in this legislation. In the year or so we have been working with the new law, we have found the "disclaimer trust" to be a highly versatile and effective tool for planning in this uncertain legislative and economic climate.

Maximizing New Increasing Exemption for Married Couples

Here's some background: It is vital that married couples provide for a special trust in their Wills which would allow both spouses to transfer up to \$2 million (in 2003) to their children without incurring an estate tax. Each individual is now entitled to an estate tax exemption of \$1 million, but a couple who transfers all of the assets to a surviving spouse can only take advantage of the surviving spouse's exemption. Having a trust in place on the first spouse's death would segregate the \$1 million exemption of the first spouse to die by retaining the assets in a trust. Income and principal may be paid to the surviving spouse (and/or children), but upon the second spouse's death, the balance of the trust would be distributed to heirs and would not be included in (i.e., would "bypass") the surviving spouse's estate.



Article Continues on Page 2

IN THIS ISSUE:

- New and Extraordinary Uses of Disclaimer Trusts
- Disclaimer Trust Case Study
- Wealth Transfer Planning Through a 529 Plan
- What We've Been Up to Lately

DISCLAIMER CASE STUDY

Hubert and Harriet, a married couple both 70 years old, have a joint brokerage account of \$1 million. In addition, Hubert and Harriet each has a retirement plan of \$500,000. The couple wishes to leave their assets for the benefit of the survivor but are amenable to setting up trusts to preserve as much of their assets as possible for the benefit of their children without compromising the surviving spouse's standard of living.

DISCLAIMER SOLUTION: HOW IT WORKS

Have Wills drafted with Disclaimer Trusts

Hold brokerage accounts jointly (as tenants by the entirety)

Designate the surviving spouse as primary beneficiary of retirement plans and Disclaimer Trust as secondary/contingent beneficiary.

After death of the first spouse, the surviving spouse could disclaim the joint property and the retirement plan assets, in which case one-half of the joint property and the retirement plan assets would pass to the "Disclaimer Trust" for the benefit of the surviving spouse. This would save over \$400,000 (assuming for example Hubert and Harriet both die in 2003). See Chart below:

Hubert's Death	Without Disclaimer	With Disclaimer
Gross Estate	\$1 Million (1/2 joint assets, Hubert's retirement assets)	\$1 Million (1/2 joint assets, Hubert's retirement assets)
Marital Deduction	(\$1 Million)	(\$0)
Taxable Estate	\$0	\$1 Million (to Disclaimer Trust-shielded by exemption)
Estate Tax	\$0	\$0 (because amount passing to Disclaimer Trust was shielded by Hubert's exemption)

Harriet's Death 2003	Without Disclaimer	With Disclaimer
Gross Estate	\$2 Million (1/2 from Hubert, 1/2 her own)	\$1 Million (Hubert's assets in Disclaimer Trust "bypass" Harriet)
Taxable Estate (assuming no deductions)	\$2 Million	\$1 Million (shielded by Harriet's exemption)
Estate Tax	\$435,000	\$0

Continued from Page 1: The Disclaimer Trust Alternative to the Traditional "Credit Shelter Trust"

The traditional "credit shelter trust" could solve this problem by mandating that an amount equal to the first spouse's exemption pass to a trust for the benefit of the surviving spouse and/or other family members. But let's say that after the death of the first spouse, there is no need for such trust either because of changes in legislation/increases in exemption or simply because the couple's assets have diminished. More importantly, since the Will works on formula clauses, with the increases in exemption, perhaps the couple would be happy with \$1 million passing to this trust for the benefit of children, but not \$3.5 million! Indeed, because of the increasing exemption couples may have to re-think the relative distribution of assets between the surviving spouse and children or other family members. Under the new law, you could run the risk of leaving your spouse without sufficient resources. This can be especially important in second marriage situations where, for instance, a portion of the estate would pass to children from the first marriage.

For these and other reasons, we have been recommending in many contexts the use of a "disclaimer trust" which could significantly reduce estate taxes (like the credit shelter trust), but can also provided needed flexibility to clients to respond to changing personal, financial and legislative changes.

How a Disclaimer Trust Works

Here's how a Disclaimer Trust in a Will would work:

1. **Outright Bequest.** The Will is set up so that all assets would pass outright to the surviving spouse.
2. **Disclaimer Trust Option.** But a "Credit Shelter-type Trust" would also be set up in the Will. The Will would provide that the surviving spouse would have the option of disclaiming the assets passing to the survivor under the Will-- in which case those assets would pass to this trust, known as a "Disclaimer Trust."

3. **Post-Mortem Election.** After the death of the first spouse, the survivor would meet with an advisor (sophisticated in estate matters) and could elect to "disclaim" all or a part of any property from the first spouse. Upon a disclaimer, the disclaimed assets would pass to the "Disclaimer Trust" set up under the Will.

Factors Advisor will Consider. In advising whether to disclaim, the advisor would meet with the client after the death of the first spouse and carefully consider (1) the size of the first spouse's estate, (2) the value of the surviving spouse's own assets including sur-

viving joint property, retirement plans and life insurance received on account of the first spouse's death, (3) the size of the estate tax exemption in that year (assuming, of course, the estate tax still exists) and (4) the financial needs of the surviving spouse and the children and grandchildren. Upon evaluation of these factors, and with considered and timely action, the surviving spouse would have the opportunity for strategic post-mortem planning.

Other Benefits of Disclaimer Strategy

Asset Protection-Maintain Assets Jointly: The Disclaimer Option allows for a married couple to maintain assets in joint form as Tenants



by the Entireties which would protect the property from claims by creditors of one spouse. Under IRS regulations, a surviving spouse can, after the death of the first spouse, disclaim the deceased spouse's half of joint property. The disclaimed property can fund the Disclaimer Trust and save considerable estate taxes upon the survivor's death.

Flexible Retirement Plan and Life Insurance Designations. A strategic plan would be to designate the "Disclaimer Trust" as a secondary (contingent) beneficiary of a retirement plan (IRA, 401(k), 403(b) etc.) or life insurance policy. Indeed, IRS regulations permit a primary beneficiary (typically the surviving spouse) to disclaim all or part of the retirement benefits, which would allow the contingent beneficiary (the "Disclaimer Trust") to collect the proceeds. This technique affords great flexibility and allows for a "wait and see" approach (until after the death of the first spouse) to evaluate optimum estate tax benefits.

Tips and Cautions for Disclaimer Technique

Post-Mortem Prompt Action Necessary. There are state and federal time limits and other requirements for a valid disclaimer. It is vital after the first spouse's death, that an advisor who is sophisticated in trusts and estates matters be consulted.

Setting up the Disclaimer Structure. In order to be "in the game" to avail yourself of the disclaimer strategy, appropriate Disclaimer Trusts and beneficiary designations must be in place before the first spouse's death.

Wealth Transfer Planning With 529 Plans

For families with minor children or grandchildren, there are 3 basic choices for making gifts to the minors: (1) transfers to custodial accounts (UTMA or UGMA), (2) transfers to trust for minors or (3) transfers to Section 529 Plans. Essentially, the 529 Plan is the most exciting and ambitious private college funding method to emerge in recent years. Contributions to a 529 Plan qualify for the gift tax annual exclusion, the investment in the plan is not subject to income tax and withdrawals for qualified higher education are tax-free.

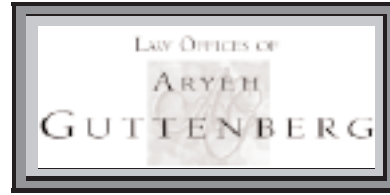
The 529 Plan is an incredible wealth-transfer vehicle, particularly for grandparents looking to pass funds to grandchildren and, at the same time, reduce their taxable estate. From an estate planning perspective, a grandparent can contribute up to \$55,000 in one year free of gift tax to an account for each grandchild. (The IRS treats the \$55,000 gift as if it were paid out in \$11,000 segments over 5 years). And, future growth is removed from the grandparent's estate. Another advantage is that grandparents remain the account owners. They can change the beneficiary or even liquidate the account if they later need the funds (for instance for a nursing home). (However, if they cash out, they would have to pay income tax and a 10% penalty). The estate planning benefits of a 529 Plan are greater than a custodial account. Like a custodial account, the transferred funds are not part of the donor's estate. But with 529 Plans, the annual gift tax exclusion is higher, the donor can retain control even after the child attains the age of 21, and, the donor can change beneficiaries to accommodate revised objectives (See Chart Below).

The 529 Plan is a phenomenal vehicle—not only for funding astronomical college costs, but as a wealth transfer device for parents and, in particular, grandparents.

Characteristic	Section 529 Accounts	Custodial Accounts	Trust for Minors
Gift Tax Annual Exclusion	Yes (w/option to "frontload" 5 years of exclusions)	Yes	Yes
Inclusion in Donor's Estate	No	No (unless donor is custodian)	No
Income Tax Deferral	Yes	No	No
Income Tax Exclusion on Withdrawal/Distribution	Yes for higher educational expenses	No	No
Limited to Higher Education	Yes	No	No
Mandatory Distribution at 21	No (donor controls age)	Yes	No (per terms of trust)
Ability of Donor to withdraw or change Beneficiaries	Yes (but withdrawal incurs penalty)	No	No

What We've Been Up to Lately

- Aryeh was admitted to the Bar of the U.S. Supreme Court in a ceremony held at the Supreme Court on March 20, 2002.
- On June 13, 2002, Aryeh was the guest speaker on estate planning at a Charles Schwab Dinner at the Harbor Court Hotel.
- On September 5, 2002, Aryeh presented a seminar in Columbia, Maryland for clients of Charles Schwab on cornerstones of estate planning.
- Kathleen L. Bell has joined our office in March, 2002 as a secretary/legal assistant. Kathleen has a B.A. in Russian language and studies from Goucher College, and has already been immersed in the world of estate planning and estate administration.
- Congratulations to our esteemed paralegal/law clerk Amanda M. Hunt on her recent engagement to Adam Franklin. Adam operates Franklin Landscaping, LLC.
- On July 1, 2002, our office celebrated its 10th Anniversary. We thank our dear clients and friends for all of your support during this first decade!



TELEPHONE: 410-484-7711
FAX: 410-484-3533
EMAIL: aryeh@guttenberglaw.com

- ESTATES AND TRUSTS
- Estate and Trust Planning
 - Will and Trust Preparation
 - Estate and Trust Administration
 - Charitable Gift Planning

- BUSINESS
- Formation – Corporations, Partnerships, Limited Liability Companies
 - Planning and Structuring
 - Business Succession Planning
 - Business Agreements
 - Mergers and Acquisitions

- TAX
- Planning and Structuring
 - Representation Before IRS and Federal Courts
 - Private Foundations

The Guttenberg Press is an informational publication and should not be considered as legal or financial advice as to any specific matter or transaction. Please contact us for further information or specific advice.

Copyright © 2003 by Aryeh Guttenberg

PRSR STD
U.S. POSTAGE
PAID
BALTIMORE MD
PERMIT NO. 6648