The Guttenberg Press

Preserving Your Assets ... Planning Your Future

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Dear Friend:

It's a simple truth of estate planning. Giving money to your heirs while you're alive is almost always a better deal, in terms of tax, than having your wealth distributed after you're gone. In our experience, the gift doesn't have to be dramatic to make it count. For many, a planned annual gift-giving program to family members can achieve great tax savings. The lead article explores the "ins and outs" of such lifetime giving.

The second article deals with the aftermath of the Schiavo case in terms of the importance of health care powers of attorney and living wills. It is an area of heightened interest and one that needs to be addressed as part of every estate plan.

The estate tax hasn't been repealed yet. But a strong possibility exists for raising the exemption and cutting the top rate. We will keep you abreast.

Let's stay in touch!

Reducing Your Estate Tax Through Lifetime Gifts

Parents and grandparents frequently make substantial gifts to their loved ones, whether to help buy a home or business, to fund a college education or to pay for needed medical care. Such gifts, however, should generally be made in a manner to maximize annual tax-free, exclusions and, if possible, avoid diminishing the lifetime gift tax exemption. Currently, that exemption is $1million. (See page 2, Column 1 for a summary of the integration of the annual exclusion and lifetime exemption.) In order to preserve this exemption at death, the following strategies are tried and true:

- *Make use of the gift tax annual exclusion.* Each individual is permitted to make up to $11,000 of gifts to any one else each year without eroding the lifetime exemption. Thus, a married couple can make $22,000 in gifts to any one individual. The number of donees is unlimited and there is no requirement that they be related to you. As part of a systematic gift-giving program, you could pass a substantial amount of wealth on to your heirs without the imposition of any gift or estate taxes.

- *Use the exclusion for tuition payments.* An unlimited gift tax exclusion also applies to tuition payments made directly to an educational institution on behalf of a student. This exclusion applies to both full-time and part-time students (even students abroad) but is limited to tuition. Expenditures for books, housing, and meals, for example, do not qualify. This exclusion is in addition to, and not in lieu of, the $11,000 annual gift tax exclusion.

- *Use the exclusion for medical payments.* An unlimited gift tax exclusion also applies for the payment of medical expenses made directly to a provider of medical care or to a provider of medical insurance. Again, this exclusion is in addition to, and not in lieu of, the $11,000 annual gift tax exclusion.

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Annual Gift Tax Exclusion and Lifetime Gift Tax Exemption:

How They Work In Tandem

You have two gift tax exclusions/exemptions to work with:

1. An $11,000 per donee annual exclusion
2. A $ 1million lifetime gift tax exemption per person. (Note that the estate tax exemption is $1.5 million in 2005 but for lifetime gifts, it is $1million.)

Essentially, if you exceed the $11,000 annual limit, the excess is counted against your lifetime exemption. So, for example, if you give your daughter $20,000 this year, $11,000 will be forever exempt from gift taxes, and the other $9,000 must be reported to the IRS and subtracted from your $1million lifetime exemption. Only when the $1million exemption is used up do you owe any gift tax. So, you have 2 numerical exclusions/exemptions: $11,000 and $1million (in addition to the gifts for tuition and medical payments).

The rationale for the $1 million exemption is to assure that individuals will not avoid the estate tax at death by simply giving their assets away while they are alive. Importantly, the maximum lifetime gift exemption is capped at $1 million even though the estate tax exemption at death is $1.5 million (in 2005) and is scheduled to increase. (Therefore, it is integrated only to a certain point.)

What about making aggregate gifts over $1 million during lifetime?

Clients are reluctant to make these gifts because they will incur a gift tax. And, with a possible repeal on the books, or the possibility of Congress' increasing the estate tax exemption to a high number, who wants to pay such a tax? But, for high net worth individuals who are sure to exceed any exemption that Congress may enact, and who feel that full repeal is an illusion, paying gift tax may make sense.

Here's why "taxable gifts" may make sense:

Suppose you earmark 4 quarters for your children. If you die and are in the highest estate bracket, almost 50% of your gift will to the government. So the children get just 2 quarters. Now suppose, instead, that you gave them 2 quarters now. You might owe gift tax (if you exceed the $1 million exemption), again at about a 50% rate. That costs you 1 quarter, not 2, and your children get to keep the extra 25 cents.

Under the first scenario, your children get 50 cents, total. Under the second, they get 50 cents in gifts plus about half of the last quarter after paying estate taxes when you die. They end up with roughly 25 cents more than they'd have received with gifts during your lifetime.

If the estate tax is repealed on schedule in 2010 – very unlikely but no one can know for sure how it will turn out – you will regret having paid gift taxes. But unless Congress acts to extend the repeal, the estate tax comes back to life in 2011 (with 2001 exemption rates!) - which would make you look very smart for distributing part of your wealth before you die, and not afterward.

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- *Split gifts between spouses.* A husband and wife have the opportunity to treat all gifts made by one of them during a calendar year as being made one-half by each of them. At first, this may not appear to be much of a benefit, but it actually is. Each spouse can use the $11,000 annual exclusion, as well as his or her own estate and gift tax exemption without regard to which spouse made the gift. They can also each benefit from the graduation in gift tax rates.

- *Give property with a high appreciation potential.* When you make a bequest at death, your heirs receive a tax basis for future capital gains tax purposes equal to the fair market value of the property at your death. In the event of a lifetime gift, however, the recipient of the gift usually takes on the same tax basis as the donor. In many cases, the tax basis will merely be the original cost to the donor. This lack of a "step up" in basis can be mitigated to large extent by giving assets that have not yet appreciated in value, but may be expected to do so in the future. None of the appreciation in value after the date of the gift will be part of the donor's estate at death, and most of the capital gains tax will be attributed to an increase in the value of the property while in the recipient's hands.

- *"Discounting" your gift.* Some wealth transfer strategies can help you stretch your exemption even further, by discounting the value of your gifts - so that a gift actually worth $15,000 say, might count as just $11,000 for tax purposes, and would not exceed the annual exclusion amount. Valuation discounts can apply to gifts of interests in real estate, businesses, or securities, among other assets. In some cases, the gift is discounted because of a lack of liquidity or control; in others, it represents a remainder interest paid after a period of time. These strategies may involve a qualified personal residence trust ("QPRT"), grantor retained annuity trust or unitrust ("GRAT" or "GRUT"), or family limited partnership LLC ("FLP" or "FLLC").

- *Make gifts to minors under the Uniform Gifts to Minors or Transfers to Minors Acts, or in trust.* Parents and grandparents often have a desire to make gifts to minor children or grandchildren. Because of their ages, however, minors are not deemed capable of managing their own financial affairs. To prevent the necessity of having a guardian appointed to handle the property of a minor, all states have enacted uniform laws that facilitate the giving of cash, securities, and other assets through a custodian designated by the donor. The custodian holds title to the property on the minor's behalf and all of the income earned belongs to the minor. While these gifts obviate the need for a trust, it must be kept in mind that the child will be the full owner of these custodial assets at ages 18 or 21 (depending upon the jurisdiction). Therefore, in many instances, a trust may be the preferred course which could allow for control even beyond the age of 21.g

HOW TO MAKE YOUR OWN HEALTH CARE DECISIONS WHEN YOU CAN'T

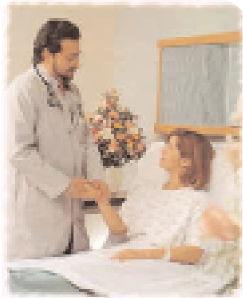
Avoid the Heartbreaking "Schiavo Dilemma"

As the contentious case of Terri Schiavo painfully illustrates, should you become physically or mentally incapacitated it's best if you can avoid forcing other people to read your mind.

The Schiavo Case. Schiavo was the 41-year-old Florida woman who died after living for 15 years in what some doctors and the courts considered a persistent vegetative state. The protracted, expensive, and excruciatingly public battle over her medical treatment probably could have been minimized or avoided if she had possessed an "advance directive" which consists of two legal documents–a living will and a health care power of attorney.

Living Will. A living will, which many people are familiar with, is a person's written expression of what life-sustaining medical treatment they wish to have or not have should they become terminally ill or are on life support and are unable to physically or mentally express that decision to their family and medical providers. Ideally, the living will should cover such issues as resuscitation, life support technologies, use of artificial nourishment, and medication and pain management.

Health Care Power of Attorney. The health care power of attorney (sometimes called a health care proxy), which is different from the durable financial power of attorney, designates a person to act as your agent (the proxy) to make medical decisions on your behalf in the event you are incapacitated. The agent's role is also to advocate on your behalf that the wishes expressed in your living will be carried out, or the agent may need to make decisions regarding gray areas not covered by the living will. At minimum, everyone should have a health care power of attorney which appoints your agent who would be empowered to make the decisions. The living will is a n optional document that can be appended to the health care power and which you should consider carefully.



Living wills and health care powers of attorney are not foolproof. Disputes can still arise among medical providers and family members. That's why it's critical to have both documents properly prepared and executed for the person to lay the groundwork for an event all of us hope never occurs.

Here are several steps to take to strengthen the effectiveness of these documents:

- Talk over what you want in the advance directive. Discuss your wishes with your loved ones, an attorney, and your health professionals in order to clarify your own thinking. Be as specific as possible to cover all reasonable contingencies.

- Appoint a strong agent. Be sure the agent understands your wishes and is strong enough to withstand possible challenges from other family members or the medical community. Medical providers sometimes refuse to abide by the living will and the agent may want to change facilities, for example. Sometimes a spouse or child is not the best choice. Appoint a backup, as well.

- Tell your loved ones. Let your family know you have these documents, what your wishes are, who's your health care proxy, and where copies can be found. Don't keep them just in your safe deposit box unless the agent has access to the box. Make sure your attorney keeps an original or copy.

- We recommend using an attorney. All 50 states allow for living wills and health care powers of attorney. But laws differ from state to state on what language can be used. There are also critical issues as to who can be valid witnesses to the signing of the documents. Because of these possible legal complications, and because the language of generic versions can be vague, we recommend that you have an attorney draft or at least review both documents so they are tailored to your desires and conform to your state's laws. The last thing you want is something open to misinterpretation or challenge. In addition, to fit your particular beliefs, circumstances and wishes, it is usually advisable to create a customized document. For example, the statutory forms may be inconsistent with Jewish and Catholic religious beliefs, or even with one's personal objectives and experience.

- HIPAA Alert. All health care powers of attorney should contain certain language which authorize the disclosure of information to the agent under the new "HIPAA" Privacy Rules. It should also specifically authorize disclosure of information to the agent regarding the issue of whether the principal is competent. Your current documents should also be reviewed for HIPAA compliance.

- Review your documents. Personal situations, medical advances, or your views may change, so review your documents periodically.

Protect Loved Ones from Heartbreak

We recommend that you execute some form of advance directive if you have not done so already. Your foresight will spare your loved ones from having to guess what your wishes might have been, and will permit your agent to act according to your own personal wishes and beliefs. We also recommend that you discuss your wishes with your family and/or your doctor. They will probably have a profound interest in any life-or-death decision-making, so it is crucial that they understand your wishes, which may be in conflict with their own beliefs. Whether you agree with Terri Schiavo's husband or with her parents, the choices are yours to make, and it is best for you and for your family to make your wishes clearly known, in writing. g

What We've Been Up to Lately

- Sandy and Aryeh are elated to announce the birth of their first grandchild, Yakira, a precious little girl born to their children, Dina and Shaye, who are residing in Palm Springs, California. May we all share news of wonderful events with you and your families.

- Aryeh has been appointed adjunct professor at the University of Maryland School of Law where he will be teaching the course on Estate and Gift Taxation in the Fall 2005.

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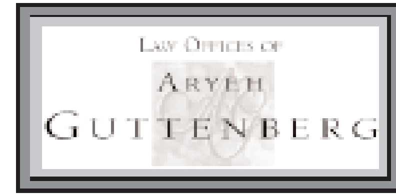
- We are proud to support the candidacy of our friend, Rick Yaffe, who is running for the Maryland House of Delegates, 11th District.

- On May 26, 2005, Aryeh and Amanda presented a two-part conference to a group of 40 life insurance professionals in Maryland (sponsored by Maryland Agency Financial Group) entitled "The New 'Decoupled' Maryland Estate Tax: Consequences and Solutions," and "A Discussion of *Chawla* and Impact on Life Insurance Trusts." The second part discussed the recent decision in *Chawla v. Transamerica*, where the court held that an insurance company was not required to pay on a life insurance claim to a life insurance trust, based in part on the trust's absence of an insurable interest in the insured. The case, which is on appeal, is certainly a bizarre one and involved a fraudulent life insurance application, among other things. The Estates and Trusts Council of the Maryland Bar is working on legislation that would clarify the area. The case in no way signals the death knell of life insurance trusts, which remains a viable strategic planning vehicle for estate tax reduction.



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