The Guttenberg Press

Preserving Your Assets ... Planning Your Future

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Dear Friend,

The Democratic victory in Congress has probably laid to rest at this time the repeal of the estate tax. But the election could very well be the impetus for compromise legislation that would fix the federal estate tax exemption at an amount in excess of the current $2 million. Perhaps $3.5 million (the scheduled exemption in 2009) may be the number. On the Maryland estate tax front, the election of Martin O'Malley as governor probably means that the decoupled Maryland estate tax is here to stay - for now.

Speaking of the Maryland estate tax, it is critical that clients take full advantage of the new Maryland-QTIP election introduced in 2006. Wills and Revocable Trusts will need to be modified in order to save federal and Maryland estate taxes. The lead article deals with this new significant legislation.

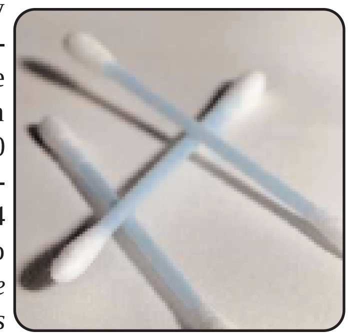
In this issue, we also discuss strategic use of generation-skipping trusts --- vehicles that could enable high net worth families to preserve assets within the family for several generations without diminution by estate taxes.

Wishing you a most joyous holiday season!

MARYLAND'S NEW ESTATE TAX REMEDY THE "STATE-ONLY QTIP"

IMMEDIATE ACTION REQUIRED!

The Maryland estate tax is harsh. As we reported to you previously and as many of our clients and friends know from our ongoing reviews, in 2004 Maryland (and many other states, including New York) "decoupled" its estate tax from the federal estate tax by reducing the estate tax exemption for Maryland domiciliaries to $1,000,000 even though the federal estate tax exemption was increasing (to $1,500,000 in 2004 and 2005, to $2,000,000 in 2006-2008 and to $3,500,000 in 2009). See Fall 2004, *The Guttenberg Press*, *"Maryland 'Decouples' Its Estate Tax: A $64,400 Trap for the Unwary– Solutions For You and Your Heirs."* The $64,400 trap actually became harsher in 2006 (with the increase of the federal exemption to $2,000,000) when married couples became exposed to a tax of $99,600 upon the death of the first spouse, and possibly even more tax on the death of the survivor!



The Bypass Trust and the Onerous Maryland Estate Tax on the Death of the First Spouse: Result Before Maryland-only QTIP

One significant estate tax savings technique for a married couple is to provide for a trust ("Bypass Trust") on the death of the first spouse that uses the first spouse's full federal estate tax exemption ($2,000,000 in 2006). That exemption would be lost if the assets passed directly to the surviving spouse. But, beginning in 2006, using that full exemption by funding a $2,000,000 trust for the surviving spouse would engender a Maryland estate tax of $99,600! And, in 2009 that tax would be $229,200!

Hobson's Choice Before the Maryland-Only QTIP

Before the advent of the Maryland QTIP, we were faced with the "Hobson's Choice" of either (1) using the full federal exemption to fund

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Maryland QTIPs: A Look At Some Drafting Alternatives

The 3 Shares

Maximum federal and Maryland estate tax savings can be achieved by a Will structure that is divisible into 3 shares, and where funds can be allocated to those 3 shares, upon the death of the first spouse. Here is a summary of the 3 shares (assuming as in 2007, a $1,000,000 Maryland estate tax exemption and a $2,000,000 federal estate tax exemption) that should be in place upon the death of the first spouse:

- Share 1: *Bypass Trust* (up to $1,000,000) to avoid Maryland estate tax and use federal estate tax exemption. This trust can be used for benefit of spouse and / or other family members and income can be accumulated to allow the trust to grow. It is also sometimes called the "family share."

- Share 2: *Maryland-Only QTIP Trust* (next $1,000,000, *i.e.*, differential between federal exemption and Maryland exemption) to avoid / defer current Maryland estate tax and use remaining federal estate tax exemption. Trust must meet "QTIP" requirements (the most important requirements are that all trust income must be paid to spouse and spouse can be the only beneficiary).

- Share 3: *Federal QTIP Trust or outright to spouse*- (amount over $2,000,000) to avoid current federal and Maryland estate tax. Trust must meet "QTIP" requirements.

Our 5 Trust Structures

We have developed 5 possible structures for our married clients that would achieve the estate tax savings and would be used as a starting point for integrating this new legislation into client's estate plans:

1. *Disclaimer Based Structure* (activated by post-mortem disclaimer by surviving spouse)

2. *Divisible QTIP-Based Structure* (one marital trust with options for the executor to divide trusts and make tax decisions after death of first spouse)

3. *Clayton QTIP Structure* (allows independent executor to divide and allocate funds with different terms after death of first spouse)

4. *Formula-Based Structure* (for larger estates- provides fixed 3-part structure based upon formula)

5. *Generation-Skipping Based Structure* (for larger estates - provides for maximum intergenerational estate tax savings)

How we structure the revised documents depends upon each client's personal and financial circumstances and intent. There is no "one size fits all" solution. Fortunately, the broad "form structures" we have developed would make the process efficient. We are presently incorporating these structures in updated Wills and Revocable Trusts for our clients.

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a Bypass Trust, but paying the Maryland estate tax on the death of the first spouse (on the $1,000,000 "gap amount" between the federal and Maryland estate tax exemptions), or (2) wasting a portion of the federal exemption but avoiding the Maryland estate tax. The first choice could cost $99,600, and the second choice could cost even more in the form of federal estate tax dollars on the death of the surviving spouse.

The Maryland QTIP Saves the Day

The new 2006 Maryland legislation allows the estate of the first spouse to utilize the full federal estate tax exemption (now $2,000,000) and still avoid a Maryland estate tax on the $1,000,000 "gap amount" by making a special "Maryland QTIP Election" on that gap amount. This election would be made after the death of the first spouse with respect to a special marital trust that meets all the qualifications of a QTIP trust under federal tax law.

<u>To take advantage of the new Maryland-only QTIP, Wills for married couples domiciled in Maryland must now include provisions for a Maryland QTIP Trust.</u>

Among the key requirements of a QTIP Trust are that only the spouse can be the beneficiary of such a trust and all income must be paid to the spouse. Through skillful drafting of a trust structure that includes a Maryland QTIP trust, it is now possible to avoid <u>both</u> federal and Maryland estate tax at the death of the first spouse to die, without wasting valuable federal estate tax exemption (and thereby save estate taxes on the death of the surviving spouse)!

We have been very busy developing solutions for our Maryland clients in order to take full advantage of the new Maryland QTIP. Our solutions were presented at the MICPEL Seminar on September 6, 2006 (*"New, Improved 2006 Maryland Estate Tax: State-Only QTIP and More")* and in the 2006-2007 supplement to our Estate Planning Book (Chapter 28.13, "*Maryland's Harsh But Improved Decoupled Estate Tax and the Advent of the State-only QTIP*").

See left column for a summary of the drafting situations and "form structures" we have developed for maximum estate tax savings .

At this time, our clients must contact us to integrate the new Maryland-only QTIP into their estate plans. And, our colleagues and financial advisors should ensure that their clients' Wills and trusts take advantage of the new tax savings opportunites presented by this legislation.

Special Alert for Unmarried Clients

The new Maryland legislation also allows unmarried clients with estates over $1 million to avoid the Maryland estate tax through lifetime gifts. Please call us to discuss how this can be accomplished.

CREATE LARGE ESTATE TAX SAVINGS FOR YOUR CHILDREN THROUGH GENERATION-SKIPPING TRUSTS

A common scenario: Parent wishes to leave assets to adult children but has one or of the following concerns or objectives:

- Parent's estate is large and inheritance to children will expose the children to estate taxes again on death of child.
- Parent's estate may not be large but child is quite successful in his/her own right and inheritance from parent will unnecessarily increase child's estate tax.
- Parent desires to leave assets to child but wishes that such assets be preserved in the family for grandchildren.
- Parent believes that assets may be jeopardized (either by child's spendthrift manner or through creditor problems) if left to adult child outright, and wishes to preserve assets for grandchildren.

A strategic solution: Parent can set up in his or her Will generation-skipping trusts for each child so that the assets at parent's death would be held for the child in trust throughout the child's lifetime, and at the child's death would pass to the grandchildren free of estate tax. In that manner, parent's objectives (as described above) could be accomplished with enormous tax savings.

The Generation-Skipping Transfer Tax ("GST Tax")

Each time a taxpayer transfers wealth to another, the transfer is potentially subject to federal transfer tax, in the form of gift or estate tax. The federal transfer tax system is designed to impose a tax on each and every generation *(e.g.*, father to son, son to grandson, etc.).

On top of the gift and estate tax, the transfer tax system accounts for the fact that a transfer might "skip" a generation by passing from parent to grandchild, for example. This is accomplished by imposing an additional tax whenever transfers of wealth are made to "skip" persons who are more than one generation below the taxpayer *(e.g.*, father to grandson). This additional tax is called the generation-skipping transfer tax and it is imposed at the highest estate tax rate in effect at the time of the transfer (46% in 2006, 45% in 2007).

GST Planning - Sheltering the Tax through the $2 Million "GST Exemption."

With the GST tax, Congress had indeed restricted opportunities to pass assets to the grandchildren and shelter such transfer from the GST tax. But Congress softened the punch of the GST tax by giving each person a generation-skipping tax exemption ("GST Exemption") which may be used during lifetime or at death. For decedent's dying in 2006 and 2007, the GST Exemption is $2 million ($4 million aggregate exemption for a married couple). This parallels the $2 million federal estate tax exemption and is scheduled to incease at the same intervels.

Effective Use of the Increased GST Exemption: Benefits to Children and Tax Savings

Generation-skipping planning is designed to set aside property for the use and benefit of children during their lifetime without having the property subject to estate tax at their deaths. If the property were left to the children outright, that property would be added to the property the children acquire on their own during their lifetimes and would increase their taxable estates at their death. This could substantially reduce the grandchildren's inheritance. The benefits of generation-skipping extend beyond the savings in estate taxes alone. The funds that would have been lost to estate tax in the children's estates are now available to be used for the benefit of the grandchildren, and even great-grandchildren. Also, because the assets are held in trust, the funds may be protected from any possible creditors, unwise spending patterns, or the effects of potential divorce or other legal process. This aspect of a generation-skipping trust may be of even greater benefit to the children than the tax savings. Additionally, the trust can be created not only to accomplish estate planning goals at this time, but also to provide children and grandchildren with flexibility to respond to future changes in the tax law.

Generation-Skipping Trusts for Married Grandparents

For married grandparents, Wills must be structured with special trusts to accomplish generation-skipping planning, since such Wills typically have three essential objectives:

#1. Provide adequately for the surviving grandparent/spouse during his/her lifetime

#2. Make full use of the $2 million federal estate exemption (from estate tax at the grandparent's level) available to each grandparent/spouse (while avoiding/deferring Maryland estate tax through a Maryland-only QTIP election).

#3. Provide generation-skipping trusts for the children/grandchildren during their lifetimes funded with the maximum generation-skipping exemption available.

We have set up many Will structures that provide for integrated estate and generation-skipping trusts that could accomplish these objectives and provide intergenerational estate tax savings. Aside from the enormous tax benefits, many clients are particularly attracted to the creditor-protection benefits afforded by such trusts. Indeed, the trusts can be drafted with great flexibility during the lifetime of the children to reduce the restrictiveness of such trusts.

Generation-Skipping for Grandparent Without Spouse

A generation-skipping trust in the Will of a grandparent who need not consider providing for a surviving spouse is much simpler. In this situation, the grandparent's estate can be distributed directly to generation-skipping trusts for each child (or if desired, one dynasty trust for all descendants). In this situation, however, care must be taken that the grandparent's $2 million exemption is not exceeded. This is done through appropriate formula clauses in the grandparent's Will.

In sum, strategic estate planning should go beyond "traditional" planning for estate tax reduction in one generation. In addition to the basics of setting up Wills with appropriate "Bypass and Marital Trusts" to maximize federal estate tax savings in the older generation (and reduce or avoid Maryland estate tax through QTIP Trusts), thought should be given to setting up generation-skipping trusts to preserve wealth for future generations. The increasing GST exemption makes this technique even more attractive, particularly for families with a high net worth.

Things We've Been Up to Lately

On September 8, 2006, Aryeh was part of a distinguished panel (that included leading officials from the Maryland Comptroller's Office and 3 other attorneys) at a seminar for MICPEL entitled "*New, Improved 2006 Maryland Estate Tax: State-Only QTIP and More.*" The seminar held at the Columbia Sheraton Hotel, produced the largest attendance at a 1-day seminar in the history of the Maryland Bar. Aryeh's presentation, entitled *"Integrating the Four Exemptions For Optimum Strategic Estate Planning for Maryland Taxpayers,"* involved the planning aspects of the new legislation.

On November 10, 2006, Elizabeth was a presenter at a seminar for NBI entitled *"Estate Planning Basics."* Elizabeth's topic was *"Drafting and Taxation of Wills and Trusts."*

We engineered a Charitable Remainder Unitrust for a major national non-profit organization and one of its donors involving the contribution of highly appreciated publicly-traded stock, with significant tax benefits for the donor – and vital source of needed funds earmarked for a specific project of the organization.

Congratulations to Bishop Aubrey A. Harley, senior pastor and founder of Deeper Life Church of Baltimore, Maryland on his consecration and installation to the sacred office of Bishop at a ceremony held on September 23, 2006. Amanda attended the ceremony and the gala banquet that followed.

Congratulations to our dear friend Karen "Chaya" Friedman on her reelection as Orphan's Court Judge for Baltimore City. Thank you to all our friends who supported Chaya.

Aryeh has been elected to the National Board of Shaare Zedek Medical Center of Jerusalem and will be assisting the hospital in its campaign for a new Children's Hospital.

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