The Guttenberg Press

Preserving Your Assets ... Planning Your Future

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Winter 2006

Welcome Elizabeth Anne Green

We're growing! It is in that vein and with great excitement that we welcome Elizabeth Anne Green who has joined us as an attorney in January 2006. Elizabeth has most recently practiced in the Personal Wealth, Estates and Trusts Department of the regional law firm of Saul Ewing LLP. Elizabeth will continue her practice in the areas of estate planning, probate, charitable gift planning and corporate law. Elizabeth will be joining attorney Amanda Hunt Franklin, our paralegal, Liz Lefkowitz, and myself as our "boutique" legal team, where we continue to combine sophisticated and innovative estate planning solutions with a warm, personalized and attentive relationship with our clients.

Please take a few moments to look at our new website **www.guttenberglaw.com** to learn more about Elizabeth and our practice.

Best wishes for a happy, healthy and prosperous 2006! As always, let's stay in touch!

Federal and Maryland Estate and Gift Tax Changes Effective in 2006

The major estate tax changes took place in 2001 and 2004. In 2001, Congress (under EGTRRA) increased the federal estate tax exemption and reduced rates in stages with a "repeal" in 2010 and a "sunset" in 2011. In 2004, the State of Maryland as well as other states, including New York and New Jersey, passed its own estate tax provisions which effectively "decoupled" its estate tax from the federal estate tax. These legislative changes still mandate a necessary review and possible restructure of all estate planning documents designed to reduce estate taxes. Thankfully, we were able to adjust the estate plans of most of our clients. But, the 2006 federal change raises the stakes and increases the tax exposure.

The 2006 Exemption Increase and Impact on Estate Plans

In 2006, the federal estate tax exemption increases from $1,500,000 to $2,000,000. (The next increase (to $3,500,000) is scheduled to take effect in 2009.) Taking advantage of the $2,000,000 exemption for each spouse effectively doubles a married couples' exemption to $4,000,000. The way to accomplish this in a manner which does not diminish the amount available to the surviving spouse is through a "formula credit shelter or bypass trust" or a "disclaimer trust."

> ***Recommendation***: Estate plans of married couples with $1,000,000 or more of assets should have a formula clause bypass/credit shelter trust or disclaimer trust incorporated in their Wills or Revocable Trusts. (While the threshold is $2,000,000 for federal estate tax purposes, the $1,000,000 threshold is to protect residents of Maryland and other decoupled states (such as New York and New Jersey) from state estate tax.)

The 2006 Trap/Decision for Married Couples Domiciled in Maryland

The increase in the 2006 estate tax exemption to $2,000,000 per person poses a tax trap for married couples who wish to utilize the full $2,000,000 estate tax exemption. As we discussed in our Fall 2004 newsletter ("Maryland Decouples Its Estate Tax: A $64,400 Trap for the Unwary - Solutions for you and your Heirs"), the full use of the federal estate tax exemption for tax planning Wills which employ trusts to maximize the federal estate tax exemption now engenders a larger Maryland tax - of $99,600! The tax exposure increases from $64,400 in 2005 due to the $500,000 increase in the federal estate tax exemption. In some cases, it makes sense to pay the Maryland estate tax in order to preserve the full advantage of the new federal estate tax exemption on the death of the surviving spouse. In some cases, however, it makes more sense to avoid paying the Maryland estate tax.

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THE ROTH 401(K) ARRIVES IN 2006

The "Roth 401(k)" became effective on January 1, 2006. Basically, it's a great opportunity for those currently participating in a 401(k) plan who always wanted to contribute to a Roth IRA but haven't been able to because of the adjusted gross income limits (*e.g.*, $160,000 for marrieds). If the employer decides to offer a Roth 401(k), you will be able to contribute up to $15,000 in 2006, plus a $5,000 catch-up contribution if you're age 50 or older. The contribution can be made in any combination of Roth 401(k) or traditional salary deferral 401(k) contributions.

The Roth 401(k) is a cross between a Roth IRA and a 401(k). Here are the similarities and differences:

◗ Like a 401(k), employee contributions are taken out of the employee's paycheck and deposited into selected investment alternatives.

◗ Like a Roth IRA, an employee contributes "after-tax dollars," but withdrawals in retirement will be tax-free if taken after age 59 1/2 and after at least 5 years from the date of the first Roth contribution.

◗ Unlike a Roth IRA, there will be required withdrawals at age 70 1/2, such as would be incurred with a 401(k) plan or a traditional IRA.

In sum, the Roth 401(k) is now available. If your employer elects to offer the Roth 401(k) feature, you will need to assess the benefits of making (1) "after-tax" contributions with tax-free withdrawals (Roth 401(k)) or (2) the current tax advantages of the "pre-tax" 401(k) (although future withdrawals will be taxed, but perhaps at a lower rate). Finally, it is always important to integrate your decision with your overall estate plan.

NOTE: *The June 13, 2005 edition of the Wall Street Journal contains an excellent description of these choices ("IRA vs 401(k)vs. SEP vs... ......). Please call or e-mail us if you would like to receive a copy of this article.*

Increased Contribution Limits for Retirement Savings

As the table below shows, some contribution limits for retirement plans increase in 2006. Of course, maximizing contributions can significantly improve your financial security and save taxes.

CONTRIBUTION LIMITS			
Year	401(k), 403(b), Salary Reduction SEP and 457 Plans	Simple IRAs	Traditional and Roth IRAs
2005	$14,000	$10,000	$4,000
2006	$15,000	$10,000	$4,000

CATCH-UP CONTRIBUTION LIMITS *			
Year	401(k), 403(b), Salary Reduction SEP and 457 Plans	Simple IRAs	Traditional and Roth IRAs
2005	$4,000	$2,000	$500
2006	$5,000	$2,500	$1,000

*Only individuals aged 50 and older can make catch-up contributions

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Recommendation: This is a determination that needs to be personalized and that has significant estate tax effects. We have developed solutions and strategies that could be implemented after we discuss the variables with you. ***Please call us for our updated "short form" to complete and to set up a time to discuss.***

Generation-Skipping Transfer ("GST") Tax Exemption Rises to $2,000,000 in 2006

The GST Tax Exemption is a separate exemption from the estate tax exemption and is used to transfer assets in a family trust for descendants with significant estate tax reduction for the next generation. In 2006, the GST Tax Exemption increased from $1,500,000 to $2,000,000. This means that a married couple with a high net worth can shift up to $4,000,000 of their estate to children and grandchildren and save substantial estate tax for the succeeding generations. This type of trust can also preserve assets for beneficiaries and protect the assets from creditors, effects of divorce and other circumstances.

Recommendation: Families with high net worth or where the next generation is otherwise well-provided for should consider providing for intergenerational trusts. Under these trusts, the children could still have access to the inheritance during their lifetimes. The trust could also be structured in Maryland as a "Dynasty Trust" under relatively recent legislation which allows use of perpetual trusts.

No Increase in Federal Gift Tax Exemption

The federal gift tax exemption has not increased in 2006, and the exemption for aggregate lifetime taxable gifts remains at $1,000,000.

Comment: In planning estates and making lifetime gifts, one needs to be mindful of the widening and varying gap between the lifetime estate tax exemption (now $2,000,000) and the lifetime gift tax exemption (a static $1,000,000). This is critical when planning to maximize the full gift tax exemption through lifetime gifts.

Inflationary Increases for Annual Gift Tax Exclusion

Effective in 2006, the annual exclusion for annual tax-free gifts increased from $11,000 per donee to $12,000 per donee (or $24,000 per donee for married persons electing to split gifts).

Suggestion: While December is the time gifts are most often implemented, we recommend making such gifts early in the calender year. This would enable the gift to appreciate in the hands of the donee (*e.g.*, children/grandchildren)

Retirement Plan Changes for 2006

See adjacent column (to the left) for a summary of the new Roth 401(k) which arrived in 2006 as well as increased contribution limits for retirement savings.

If you wish to discuss how these changes affect your estate plan, please contact us at 410-484-7711 or via e-mail.

Don’t "Mess Up" The Marital Deduction! Sloppily-Drawn Wills Can Cause Major Estate Tax Problems

Let's face it. The Estate and Gift Tax is complex. We practice in the area and analyze it every day. While we look at the "big picture," the "devil is in the details," which means knowing the parameters of the tax laws. One simply cannot "wing" estate planning -- certainly not when we’re dealing with the marital deduction. The marital deduction allows assets to pass estate tax-free from one spouse to another. If not drafted with precision, the marital deduction can be lost, with substantial and unexpected adverse tax results. Just took at the *Sowder* case.

The Sowder Case

In a recent case in the State of Washington (*Sowder v. U.S.*), a businessman drafted his own Will, making cash bequests to his adult children to soak up his estate tax exemption. He then drafted language which he thought left the balance of his estate to his wife. Here's his language:

> "All the rest, residue and remainder of my estate, both real and personal, of every nature and wherever situate, of which I may die seized or possessed, I give, devise and bequeath to my wife, Marie L. Sowder, if she survives me, and if she does not survive me, *or dies before my estate is distributed to her,* to my issue surviving, in equal shares *per stirpes*." (Italics added).

Now, this appears to be a straightforward bequest to the surviving spouse. As assets passing to a spouse generally do not generate any estate tax, Mrs. Sowder filed a federal estate tax return fully expecting no tax due to the estate.

IRS Challenge and an Arduous 10 Year Voyage

Unfortunately, the IRS said no – the language the husband used made the share ineligible for the marital deduction. Technically, the language in the bequest (italicized) created a prohibited terminable interest, *(i.e.*, an interest that although MAY pass to the surviving spouse, might also terminate.) Instead of $0 tax, the IRS assessed a tax liability of $828,678 and more than $133,000 in interest. A shock to the family! (See right column for a discussion of a crucial exception to the "terminal interest rule" and its application to marital trusts.)

It took several years for a court to straighten out the mess, overruling the IRS' objection and allowing the use of the marital deduction. The estate was finally saved by a sharp estate tax attorney, since the decedent's state of residency, Washington, had a statutory policy of "fixing" problematic terms in Wills after death based on evidence of the decedent's intent. But the self-drafted Will tied up the estate for 10 years after death.

It’s so easy to get trapped by the myriad of tax rules that apply to matters that appear to be straight forward. A simple bequest to the surviving spouse can pose a significant trap for the unwary when just a few extra words are included.

THE MARITAL/QTIP TRUST: A KEY ALTERNATIVE TO THE OUTRIGHT MARITAL BEQUEST

One of the most important techniques allowed by the estate tax law is the "QTIP/Marital Trust." The IRS allows one spouse to set up the QTIP/Marital Trust for the benefit of the surviving spouse during his or her lifetime. This Trust can direct where assets pass at the death of the surviving spouse. The primary advantage of the QTIP/Marital Trust is the providing of financial security for the surviving spouse while preserving the assets for children. This trust would protect assets from a spouse's subsequent remarriage (without regard to whether the spouse will enter into a prenuptial agreement with a second spouse) and from creditors, thereby ensuring that the assets will eventually be distributed to the children.

The QTIP/Marital Trust should be strongly considered in the following situations:

- Second marriage, with children from the first marriage
- Concern with surviving spouse's ability to manage assets
- Asset protection concerns- protect surviving spouse from creditors/second marriage

We’ve launched our updated and enhanced website, www.guttenberglaw.com

Easy navigation, timely and useful estate planning information, breaking news, description of our practice and our team, articles, publications and PowerPoint presentations are just a few of our features. Please visit our site and, of course, e-mail us with any questions or comments

Things We've Been Up to Lately

◗ Congratulations to our esteemed associate, Amanda Hunt Franklin, and her husband Adam on the birth of an adorable baby girl, Ella Tierney, on August 31, 2005. Amanda has been a key part of the practice for the past 6 1/2 years, having worked full-time while successfully completing law school, passing the Maryland Bar Exam and now shining as attorney and devoted mom.

◗ We are happy to announce the birth of Aryeh and Sandy's second grandchild, Mordechai, a precious little boy born to their children, Leba and Gary of New York City. Pictured (from Mordechai's Pidyon HaBen) are 5 generations--from great-great grandmother, Esther Metzger, to Mordechai!

◗ Aryeh has been appointed to the distinguished Section Council of the Estate and Trust Law Section of the Maryland Bar, where he has been appointed co-editor of the Estates and Trusts newsletter.

◗ Aryeh was a presenter at a seminar on September 15, 2005, at the Baltimore Hyatt Hotel on "Strategic Estate Planning Techniques and Developments in Maryland." Aryeh spoke on "Flexible Estate Planning for Married Couples in a Period of Legislative Flux." Aryeh's written presentation is available by e-mailing or calling us.

◗ In December 2005, we set up a charitable structure which included a charitable remainder trust (CRT) and a private foundation. As part of the plan and to enhance the income and estate tax benefits, the foundation was the remainder beneficiary of both the CRT and the client's IRA.

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