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# SNIPPETS

AN ESTATE PLANNING AND FINANCIAL PLANNING NEWSLETTER  
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## Estate Planning in a Down Economy – Navigating Through the Perfect Storm

Most people are aware that estate planning can provide them with several benefits including: providing for their family and friends, avoiding probate, reducing estate taxes, helping a favorite cause, and planning for incapacity. With the economy in turmoil, many people feel this is not the appropriate time to focus on estate planning and the prudent course of action is to postpone any planning until they receive clear indications that the economy is going to recover. However, the continual decline in asset values coupled with interest rates at an all time low creates a “perfect storm” for certain estate planning techniques, allowing individuals to pass more to future generations and reduce or eliminate estate taxes. There are a number of estate planning strategies that allow you to take advantage of a bad economy. The following are a couple of effective and easy to implement

techniques for you to consider during these economically trying times:

### Gifting

For Federal purposes, as of January 1, 2009, you can now gift up to \$13,000 (“annual exclusion”) to any individual without any gift tax consequences and with the added benefit that all future appreciation (we hope) is removed from your estate. A married couple can transfer double the annual exclusion amount per year per beneficiary to \$26,000. The current law allows individuals to make \$1.0 million in taxable gifts (the gift amount that exceeds the annual exclusion) without paying a gift tax by reducing their \$3.5 million estate tax exemption during their lifetime.

The Massachusetts estate tax exemption is \$1.0 million, which is significantly

lower than the Federal estate tax exemption that is currently at \$3.5 million. This means that if your taxable assets are between \$1.0 million-\$3.5 million your estate will not have to pay a Federal estate tax but would be subject to the Massachusetts estate tax. There are two significant advantages of gifting for Massachusetts residents. First, Massachusetts does not have a gift tax. Second, Massachusetts reduces the \$1.0 million estate tax exemption for lifetime gifts but unlike the Federal estate tax, does not add back lifetime gifts to calculate the estate tax. Therefore, lifetime gifting will not eliminate an individual's Massachusetts estate tax liability but will result in a significant reduction to their potential estate tax liability.

It is the general public consensus that business and real estate values may be down as much as 20% since last year at this time. This creates opportunities for transferring the business, stock or assets to children or key employees at significantly less tax cost than prior years and results in using less of your lifetime gift exemption of \$1.0 million or your federal estate tax exemption of \$3.5 million. Additionally, capital gains tax rates are at an all time low for most individuals which will probably not last in the face of trillion dollar deficits. Income tax rates are also on the way up. Therefore, Corporations can redeem stock of the owners at this low rate and effectively transfer more of the company to their children or key employees.

Further techniques involving the leveraging of the annual exclusion may allow you to transfer assets with a low value today, but which you anticipate

will rebound in the future while completely avoiding transfer taxes.

#### Intra-Family Loans

If you are not inclined to currently make a direct gift to your child, or your child is having difficulty qualifying for a bank loan, or is facing a very high interest rate, then another effective estate planning technique to consider is making an intra-family loan. Loans to family members are a well-established estate planning technique and are very effective means of transferring wealth to your children. An intra-family loan will allow you to take advantage of rock-bottom interest rates should you want to help your child take advantage of an investment opportunity, business start-up, education or home purchase. With interest rates at all time lows, you can loan the money for use in investing. The IRS sets minimum rates for such loans, that are well below current bank rates, depending on the maturity of the loan. For example, the February 2009 rates ranged from 0.60% to 1.65%. The low IRS rates will assist your child by requiring smaller payments and do not greatly increase the amount coming back into your estate.

Another effective estate planning technique using intra-family loans is to make a low-interest loan to a child but forgive part of that loan each year through the annual gift-tax exclusion. By using your annual gift exclusion in conjunction with intra-family loans, gifts of the loan's principal are made yearly by forgiving that amount due. This technique will result in maximizing the transfer of wealth from one generation to the next and lowering your overall estate tax burden.

If you are considering making an intra-family loan, you must properly document these loans to ensure you receive the intended benefits.

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### **Current Status of the Federal Estate Tax – President Obama Budget Proposal Addresses Estate Tax Law**

During President Obama's first few months in office, the first steps have been taken to address the uncertainty surrounding the Federal estate tax. On February 26, 2009, President Obama released his 2010 budget proposal. Buried in a footnote on page 121 of the proposal, the budget document states, "the estate tax is maintained at its 2009 parameters." So what does this mean? In order to answer that question you must understand the current Federal estate tax laws in place.

The current Federal estate tax law can be found under in the 2001 Economic Growth and Tax Relief Reconciliation Act ("EGTRRA"). EGTRRA increased the Federal estate tax exemption from \$675,000 to \$3.5 million over an eight-year period. On January 1, 2009, the exemption reached the top end of that range leaving us with a current Federal estate tax exemption of \$3.5 million. These exemption increases were enacted because every year there were more and more millionaires and the goal was to only apply the estate tax to a certain percentage of our population. Where the uncertainty was created was that EGTRRA also provided for full repeal of the estate tax in 2010, but the law automatically expires one year later; meaning the Federal estate tax exemption will fall back down to \$1.0 million starting in 2011. EGTRRA also reduced the top estate tax rate from 55%

to 45%, but this reduction will also expire in 2011. Therefore, unless Congress takes action, this leaves us with a \$3.5 million federal tax exemption through the end of this year, a one-year estate tax repeal in 2010 and subsequent reduction to \$1.0 million in 2011, Crazy!!!

So the footnote on page 121 of Obama's 2010 budget proposal, which simply states, "the estate tax is maintained at its 2009 parameters" will result in a significant tax policy change. It could freeze the 2009 estate tax laws currently in place. What this means to you is a 45% tax rate on estates. An individuals' estate of \$3.5 million or less would be exempt and a married couple's estate (with proper planning) valued at more than \$7.0 million would also be exempt from Federal estate taxes.

This is President Obama's current position on the estate tax but the pressure will now be on Congress to reach a consensus before the end of the year to avoid the prospect of repeal in 2010. Although the House Republicans would prefer to see a slightly higher exemption and/or a slightly lower tax rate, it is likely that the President will obtain the support in the House, as both parties in the House have tended to support estate tax relief measures. The Senate is most likely where the President will find his strongest opposition. The issue that the President will face is that his proposal of freezing the estate tax rates and exemption at the 2009 amounts would result in the reduction of significant future government revenue. In order to make such an action permanent, any legislation that will reduce government revenue in any year beyond the next five years require either

offsets or a 60% “supermajority” vote in the Senate. Proposed estate tax legislation in 2006, 2007 and 2008 to set the exemption at \$5.0 million and lower the estate tax rates have fallen a few votes short of the 60% “supermajority” vote needed. That was the position when the economy and government was in a much better fiscal situation. Alternatively, if a comparable bill with a slightly lowered exemption and higher rates was proposed it would likely pick up votes from Democrats, but may lose an equal number of Republican votes. However, with the clock ticking down before the 2010 estate tax repeal and significant reduction in the exemption and tax rates in 2011, it is probable that a consensus will be achieved in Congress and we will see the estate tax maintained at the 2009 levels or perhaps even a lower threshold.

As estate planners have had to address the uncertainty of the estate tax for almost a decade now, we are able to create estate plans that are flexible enough to effectively deal with any uncertainty in the tax laws. Furthermore, estate planning is not limited to strictly Federal estate tax planning. For those of you Massachusetts residents the state estate tax exemption is currently set at \$1.0 million and not scheduled to change. Although, the Massachusetts estate tax rates are generally lower than the Federal rates (.8%-16%), the Massachusetts estate tax can still be significant. For example, a Massachusetts resident with a \$1.5 million dollar estate is not subject to the Federal estate tax but may have to pay up to \$64,400 of Massachusetts estate tax. In addition to estate taxes there are numerous other estate planning issues that still need consideration such as,

asset protection, proper titling of assets, powers of attorney, health care proxies and guardianship of minor children. Therefore, if you do not have any estate planning in place or have not revisited your plan for several years you should not ignore this important planning for you and your family.

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### **Estate Planning and Probate Alert – Massachusetts Adopts the Uniform Probate Code**

On January 15, 2009, Massachusetts adopted the Uniform Probate Code (“MAUPC”) resulting in major changes to the current guardianship, probate and trust laws. The new Massachusetts Probate Code creates a new efficient system for administering estates by permitting as little or as much oversight by the Court as may be appropriate for the needs of beneficiaries and provide increased sensitivity and protections for the right of those individuals under Guardianship. Here are a few of the highlights of the changes made by the MAUPC:

1. Mandating courts to monitor guardianships and requiring guardians to issue annual reports.
2. Shorten to seven days after the date of death (from as long as five months) the length of time it takes to appoint an estate administrator.
3. In the case of no will, the spouse gets the entire estate if the children are all of the marriage.
4. Trustees will be required to notify beneficiaries of accountings and acceptance of appointment.