

Current and Year-End Estate Planning Issues

December 2, 2008

FEDERAL GIFT TAX ANNUAL EXCLUSION INCREASE; TUITION AND MEDICAL PAYMENTS

The Federal gift tax Annual Exclusion, which currently allows a donor to give up to a total of \$12,000 per individual recipient in any year without incurring a gift tax, will increase to \$13,000 per individual recipient in 2009. A married couple can “split” all gifts on gift tax returns for the year and will be able to give a total of \$26,000 gift tax free to any number of individual recipients.

In addition to the Annual Exclusion, there continues to be an exclusion from Federal gift tax for payment of another person’s tuition or medical expenses (including medical insurance premiums), so long as the payment is made directly to the institution providing education or directly to the health care provider. This exclusion is unlimited both with respect to the amount of the payment and the number of allowable recipients.

GIFTS OF ASSETS WITH DEPRESSED VALUES

The current market turmoil may create an opportunity for making transfer tax efficient gifts. Giving assets with low current values may mean that more future value can be transferred at a lower gift tax cost or with less use of the Annual Exclusion or lifetime gift tax exclusion (\$1 million per individual) if the values of the transferred assets increase after the gift is made.

TAX-FREE DISTRIBUTIONS FROM IRAS TO QUALIFYING CHARITABLE ORGANIZATIONS

The Emergency Economic Stabilization Act of 2008 extends through December 31, 2009 the exclusion from gross income of up to \$100,000 per year of otherwise taxable distributions from certain IRAs, provided the distributions are made directly to a qualifying charitable organization (under prior legislation, this exclusion expired on December 31, 2007). The following conditions apply: (1) distributions must be to certain public charities (and, notably, cannot be to donor-advised funds); (2) the IRA owner must have attained age 70½ at the time the distributions are made; and (3) the distributions must be made before 2010. Whether it makes sense to use this exclusion will depend on a number of factors, including income level, assets available for charitable giving, and the level of an individual’s charitable giving.

SHORTENED EXTENSION FOR FILING TRUST AND ESTATE INCOME TAX RETURNS

Currently, a fiduciary may apply for an automatic six-month extension for filing Federal income tax returns of trusts and estates. For Federal income tax returns of trusts and estates due on or after January 1, 2009, the automatic extension will be for only five months.

TRANSFER TAX ON RECIPIENTS OF GIFTS OR BEQUESTS FROM CERTAIN EXPATRIATES

Effective for gifts and bequests received on or after June 17, 2008, if a U.S. citizen or resident receives gifts or bequests having an aggregate value of more than the Annual Exclusion (\$12,000 in 2008 and \$13,000 in 2009) in any taxable year from a "covered expatriate" (a term which includes an expatriate who exceeds a minimum income or net worth level), the recipient must pay a transfer tax on the amount by which the gifts or bequests exceed the Annual Exclusion. The rate of such tax is the greater of the highest Federal estate tax rate and the highest Federal gift tax rate in effect in the year that the gifts or bequests are made. The tax is reduced by any gift or estate tax paid to another country with respect to such gifts or bequests. Certain charitable transfers and transfers to spouses are exempt from this transfer tax.

FEDERAL APPLICABLE EXCLUSION INCREASE; POSSIBILITY OF INCREASED STATE ESTATE TAX ON YOUR ESTATE

Married taxpayers can design their estate plans so that on the death of the first spouse to die there is no Federal estate tax, while ensuring that the maximum amount of the assets of the first spouse to die is sheltered from Federal estate tax in both spouses' estates. This maximum amount, called the Federal Applicable Exclusion, currently \$2 million, will increase to \$3.5 million in 2009, and then, in the absence of new legislation, be unlimited in 2010 and fall back to \$1 million in 2011.

Segregating the Federal Applicable Exclusion on the death of the first spouse to die so that it is not added to assets that pass to the surviving spouse will prevent such amount from being included in the Federal taxable estate upon the survivor's later death. Therefore, many estate plans provide that the entire Federal Applicable Exclusion is held in a trust for the spouse and descendants. This approach may create a state estate tax at the death of the first spouse to die because in some states the state Applicable Exclusion amount is less than the Federal Applicable Exclusion. To avoid the state estate tax, you may need to change your Will.

For example, the New York Applicable Exclusion is \$1 million. Therefore, if you are a New York resident, New York estate tax will be imposed on any amount over \$1 million that does not pass in a manner that qualifies for a New York marital or charitable deduction. For New York residents dying in 2009 with a trust for spouse and descendants funded with the full Federal Applicable Exclusion (\$3.5 million), no Federal estate tax will be imposed at death, but New York estate tax of \$254,911 will be imposed. The New York estate tax may be avoided by capping the amount passing

to the trust for spouse and descendants at the lesser of the Federal and New York Applicable Exclusion. However, such action will result in a loss of some of the Federal Applicable Exclusion, meaning potentially higher taxes at the death of the second spouse to die.

Whether an individual should cap the amount passing to the trust for spouse and descendants at the lesser of the Federal and New York Applicable Exclusion will depend on a number of factors, including the amount of lifetime gifts and projections regarding the size of the surviving spouse's taxable estate and the Applicable Exclusion and tax rates in effect at the survivor's death.

EFFECTIVE COMBINED ESTATE TAX RATE FOR NEW YORK RESIDENTS

The following chart shows the combined effective Federal and New York estate tax maximum marginal rates for the years 2009 through 2011 in the absence of new legislation:

CALENDAR YEAR	MAXIMUM FEDERAL RATE	MAXIMUM NEW YORK RATE	EFFECTIVE COMBINED MAXIMUM RATE AFTER DEDUCTION OR CREDIT OF NY ESTATE TAX
2009	45%	16%	53.80%
2010	0%	16%	16%
2011 ¹	55%	16%	55%

AUTOMATIC ALLOCATION OF GST TAX EXEMPTION

Generation-skipping transfer ("GST") tax is a tax imposed on transfers by gift or upon death or transfers from trusts to persons two or more generations below the person making the transfer or who created the trust. The GST tax exemption for each individual, currently \$2 million, will increase to \$3.5 million in 2009, and then, in the absence of new legislation, be unlimited in 2010 and fall back to \$1 million in 2011. The GST tax exemption is valuable because if GST tax exemption equal to the value of the transferred property is allocated to a trust transfer, the transferred property and post-transfer income and appreciation should be exempt from any further gift, estate or GST tax for the term of the trust. Prior to 2001, GST tax exemption was allocated to a trust transfer if the donor

¹ In 2011, there will be an additional 5% Federal estate tax on the portion of the taxable estate between \$10,000,000 and \$17,184,000. If the total amount of the taxable estate is within this range, the effective combined maximum estate tax rate will be 60%.

allocated GST tax exemption on his or her gift tax return. Since January 1, 2001, however, GST tax exemption is automatically allocated to all transfers to certain types of trusts, unless the donor affirmatively opts out of automatic allocation on his or her gift tax return.

Each year, you should alert your accountant to transfers you make to trusts (including life insurance premiums paid with respect to insurance trusts) and determine whether you should opt out of, or into, allocation of GST tax exemption (and whether to opt out or in on a permanent basis) so that your gift tax return, which is due on April 15th of the year following the year of the transfer, can be prepared appropriately.

If you have any questions about the estate planning issues described in this update, please contact Mildred Kalik (mkalik@stblaw.com; 212-455-2778), Pamela L. Rollins (prollins@stblaw.com; 212-455-3468), or any other member of our Personal Planning Department.

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