

Fall 2008 Estate Planning Newsletter

Challenging Economic Times Create Opportunities

We are all aware of the current turmoil in the financial markets and the deepening weakness of the economy. These factors are having a significant negative impact on many businesses. As odd as it may seem, these troubling times can also provide some of the best opportunities to transfer wealth to younger generations while minimizing estate and gift taxes.

Many of our clients, and in particular, closely-held business owners, have revalued their businesses in light of the economic downturn in preparation for transferring equity in the family business to their children. Some of our clients have transferred as much as 90% of the equity in their businesses without giving up voting control. Others have transferred stock worth millions of dollars at little or no gift tax cost by using an "Intentionally Defective Grantor Trust" or a "Grantor Retained Annuity Trust." Both vehicles can reduce gift and estate taxes.

Individuals, in addition to closely-held business owners, are also taking advantage of the reduction in value of their homes and stock portfolios. Transferring assets that will rebound will invariably save estate taxes. Some individuals are transferring their primary residences or vacation homes to a "Qualified Personal Residence Trust" at a time when the value of their home is likely worth less than it will be in the future. After a term of years, the property will be distributed to their children without any further transfer costs.

If history is any indication, the markets will recover and values will increase. This may be an opportune time to take advantage of the downturn.

President-Elect Obama and the Federal Estate Tax

The future of the federal estate tax remains uncertain. The federal estate tax was a major political battleground in the recently concluded presidential election and continues to attract interest in Congress. For 2008, the federal estate tax exemption is \$2 million with a flat rate of 45% on amounts above the exemption. In 2009, the federal exemption will increase to \$3.5 million and, under current law, the federal estate tax is scheduled to be repealed for one year in 2010. Without Congressional action to reform the estate tax, it will be reinstated in 2011.

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with a lower exemption and higher marginal top rate. In 2011 and future years, the federal exemption is only \$1 million with a marginal top rate of 55%.

During his campaign, President-elect Obama proposed freezing the estate tax exemption and top tax rate at their 2009 levels: that is, at \$3.5 million and at 45%. President-elect Obama also campaigned on the platform that the estate tax should be eliminated for 99.7% of families, and he believes that the 2009 exemption amount will have that result. President-elect Obama has also agreed to consider making the federal estate tax exemption "portable" for married couples. In other words, any unused exemption at the first spouse's death would become transferable to the other spouse to increase his or her exemption. One last key estate tax issue that President-elect Obama supports is keeping the current system of a 100% step-up in cost basis for valuing inherited property.

We do not know how quickly the changes to the estate tax will happen and what the effective date might be, but any changes will most likely not be enacted until President-elect Obama and the 111th United States Congress take office in January 2009. Most experts agree that legislation will be passed by Congress prior to the repeal of the estate tax in 2010. Our attorneys will continue to monitor the activity in Congress regarding changes in the estate tax.

Charitable IRA Rollovers Extended for 2008 and 2009

In 2006 and 2007, Congress allowed taxpayers who are 70 1/2 and older to move funds directly from their IRAs to charitable organizations, and to "count" the charitable gifts against their required distributions from the IRAs. This tax planning opportunity ended last year, but has now been extended for this year and next. Clients who would like to make charitable gifts with their pre-tax IRA funds can now do so through the end of 2009.

The rules for "Qualified Charitable Distributions" from an IRA have not changed. These rules are:

- The taxpayer must be 70 1/2 or older at the time of the charitable IRA rollover;
- The maximum Qualified Charitable Distribution per taxpayer is \$100,000 per year. Note that married couples, each of whom is 70 1/2 or older and each of whom has an IRA, can effectively double this annual maximum gift if they both make the charitable IRA rollover; and

- The charitable IRA rollover must pass directly to a public charity, or to a "conduit" foundation. It cannot be made to a private foundation (other than a "conduit" foundation), "donor advised fund," "supporting organization," or "split interest trust" (as for example, a charitable remainder trust).

Charitable IRA rollovers are treated as part of the taxpayer's "required minimum distribution" for the IRA and so reduce the net amount the clients must take out of the IRA for themselves.

Clients who benefit most from charitable IRA rollovers include those who are charitably inclined and are looking for ways to maximize the after-tax benefit of making their charitable gifts. For example, a client who makes annual gifts in excess of her annual deduction limit (generally 50% of her adjusted gross income) can make a charitable IRA rollover without the amount of the gift being added to the amount of her charitable gifts. This approach effectively allows the client to deduct more of her other gifts to charity during the year. Other clients who are subject to the 3% reduction in itemized deductions can benefit from charitable IRA rollovers, as can clients who do not itemize their charitable gifts at all. Finally, clients can reduce the amount of their Social Security income that is subject to income tax by making charitable IRA rollovers rather than by taking their IRA withdrawals, adding to their gross income, and then taking a charitable deduction for the gifts.

Roth IRAs: Re-Characterize Conversions in Down Markets

Roth IRAs are tax-free retirement savings vehicles funded with post-tax dollars. Some account-owners are allowed to "convert" their regular IRAs to Roth IRAs if income limits and tax filing tests are met. Anyone who converted a regular IRA to a Roth IRA earlier this year may want to "re-characterize" the amount converted to the Roth IRA if the value has declined since the conversion. The amount of the regular IRA that was converted, plus earnings, can be transferred from the Roth IRA back to a regular IRA in a trustee-to-trustee transfer by the tax filing deadline, including extensions, and the Roth conversion will be deemed not to have occurred.

The account-owner can reduce the taxable income they have to report on a Roth IRA conversion made earlier in the year before recent market decline, by re-characterizing the Roth IRA back to a regular IRA. If they want to convert the

regular IRA back into a Roth IRA, they can do so provided they wait until the taxable year following the original conversion, and at least 30 days have elapsed after the re-characterization, whichever is later. They must also meet the income and tax filing status tests in the new year of the new conversion. By re-characterizing and re-converting Roth IRAs, clients can reduce their income taxes on converting their regular IRAs to Roth IRAs.

IRS Inflation Adjustments

The IRS has recently released inflation adjustments for numerous tax items effective on January 1, 2009. One such adjustment is an increase in the gift tax annual exclusion amount from \$12,000 to \$13,000. This means that beginning in 2009, an individual can give \$13,000 worth of assets to any number of recipients without incurring gift tax liability and without reducing the individual's \$1 million lifetime gift tax exemption. The gift tax annual exclusion is doubled for married couples so that in 2009 a couple will be able to give \$26,000 to each recipient without incurring a gift tax liability.

Other inflation adjustments effective as of January 1, 2009 include the following:

- The personal income tax exemption will increase by \$150, to \$3,650;
- The income tax standard deduction for married couples will increase by \$500, to \$11,400; and for unmarried individuals will increase by \$250, to \$5,700; and
- The maximum amount of earnings subject to Social Security tax will increase by \$4,800, to \$106,800.

New Rules Regarding Funeral Directions in Wisconsin

In March 2008, a new law regarding funeral directions was enacted in Wisconsin. The new law allows any person who has attained age 18 and who is of sound mind to execute an "Authorization for Final Disposition." The Authorization for Final Disposition takes effect on the date of execution and it may express the declarant's wishes as to various funeral and burial details. To be valid, the Authorization for Final Disposition must be signed and dated by the declarant (or if the declarant is unable to sign, by another individual at the express direction of the declarant) and the signature must be witnessed by two adult disinterested



witnesses or acknowledged before a notary public.

The Authorization for Final Disposition must also list the names and addresses of the named representative and successor representative(s) and it must also be signed by each such representative. The Authorization for Final Disposition may express the declarant's special directions, instructions concerning religious observances, and suggestions regarding arrangements for viewing, funeral service, memorial service, last rite, burial, cremation or other disposition of the declarant's body.

There is a statutory form in Wisconsin Statutes section 154.30(8)(f) that can be used, but an Authorization for Final Disposition is not limited in form or substance to the form provided. You can obtain a copy of the statutory form of the Authorization for Final Disposition along with instructions on how to complete the form.

Please contact your Reinhart attorney if you would like additional information on any of the topics discussed in this newsletter or if you would like to review and discuss your individual estate plan in more detail.

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