

Akerman Practice Update

PRIVATE CLIENT SERVICES

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Estate Planning Changes on the Horizon

A short window of opportunity remains
under proposal and economic environment

Jeffrey A. Kern
jeffrey.kern@akerman.com

Henry H. Raattama , Jr.
hank.raattama@akerman.com

The recently released Administration's Fiscal Year 2010 Tax Policy Proposals include reforms to two existing estate planning techniques for wealthy clients which are likely to be limited in the near future.

- One of the planning techniques involves the popular use of "discounting" of asset values for estate and gift tax purposes by contribution of assets to family entities (such as limited partnerships and LLC's), and gifting or selling minority interests to family members or trusts. Discounts of anywhere from 25 to 45% from the value of the underlying assets (depending on the type of asset involved) are currently obtainable if properly structured. The administration's proposal (as well as other recently proposed legislation) would severely limit this technique by reducing or eliminating the discounts otherwise available for most family assets.
- Another popular technique involves the transfer of an asset to a "GRAT" (grantor retained annuity trust) in return for a payment of a fixed amount for a term of years, after which any remaining assets (not used to make the payments) are removed from the grantor's transfer tax base. This allows a large tax free transfer of assets to younger generations as long as the actual return on the asset exceeds the assumed return published monthly in the IRS tables). Even if the asset doesn't perform as hoped for and the return is less than the "assumed return" there is no harm or loss since the taxpayer would simply receive a return of the assets, tax free and be free to engage in another transaction.

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“Since both asset values and assumed interest rates are likely to be at historic lows, and since future legislation is likely to apply prospectively (ie, should not effect plans implemented prior to enactment) action now rather than later is highly recommended.”

A requirement for the success of the GRAT transaction is the survival of the taxpayer for the term of the GRAT. The administration proposal would make success more difficult to achieve by requiring a GRAT term of at least 10 years as opposed to a current minimum term of 2 years. Other proposals are more restrictive and might eliminate GRAT's entirely.

In addition, the techniques mentioned above (among others) are greatly improved when asset values and/or assumed interest rates published by IRS tables are low in comparison to expected future values and future increases in assumed interest rates. Use of a 10 year GRAT with a transfer of \$1,000,000 under rates in effect in January of 2001, assuming an 8% total return (income and growth) would remove \$57,000 of wealth out of the estate tax free. The same GRAT using today's interest rates would remove over \$412,000 tax free.

Since both asset values and assumed interest rates are likely to be at historic lows, and since future legislation is likely to apply prospectively (ie, should not effect plans implemented prior to enactment) action now rather than later is highly recommended. This window is very likely to close in the foreseeable future.

For clients who are not so wealthy, their estate plans may be outdated. Congress will be required to act before the end of 2009 in order to avoid a scheduled one year estate tax repeal in 2009 (with lower exemptions and higher rates scheduled for future years). If legislation is not enacted, existing “will formulas” may be totally unworkable since they often define the gift by reference to the exemption. If legislation is enacted, there may be additional provisions which will require revisions to wills.

In short, although it is not easy to motivate clients to plan in these economic times, failure to advise clients of the short lived opportunities available to them might result in later dissatisfaction when the time for action has passed.

Jeffrey Kern is Of Counsel in Akerman's Miami office. His practice focuses on Capital Preservation, Private Client Services Personal, Business and Family Wealth Planning, and Taxation.

Hank Raattama is a Shareholder in Akerman's Miami office. His practice focuses on Capital Preservation, Charitable and Tax-Exempt Organizations, and Private Client Services.

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For more information, please contact Jeffrey Kern.

Denver

511 Sixteenth Street, Suite 420
Denver, CO 80202
303.260.7712

Ft. Lauderdale

Las Olas Centre II
350 East Las Olas Boulevard
Suite 1600
Ft. Lauderdale, FL 33301-2229
954.463.2700

Jacksonville

50 North Laura Street, Suite 2500
Jacksonville, FL 32202-3646
904.798.3700

Los Angeles

725 South Figueroa Street, 38th Floor
Los Angeles, CA 90017-5438
213.688.9500

Madison

222 West Washington Avenue, Suite 380
Madison, WI 53703
608.257.5335

Miami

One Southeast Third Avenue
25th Floor
Miami, FL 33131-1714
305.374.5600

New York

335 Madison Avenue, Suite 2600
New York, NY 10017-4636
212.880.3800

Orlando

CNL Center II at City Commons
420 South Orange Avenue, Suite 1200
Orlando, FL 32801-3336
407.423.4000

Tallahassee

Highpoint Center, 12th Floor
106 East College Avenue
Tallahassee, FL 32301
850.224.9634

Tampa

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401 East Jackson Street, Suite 1700
Tampa, FL 33602-5250
813.223.7333

Tysons Corner

8100 Boone Boulevard, Suite 700
Vienna, VA 22182-2683
703.790.8750

Washington, D.C.

801 Pennsylvania Avenue N.W., Suite 600
Washington, DC 20004
202.393.6222

West Palm Beach

Esperante Building
222 Lakeview Avenue, Suite 400
West Palm Beach, FL 33401-6183
561.653.5000

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