Recent Estate Planning Developments and Newsletter

Winter 2007

A Summary Provided by the:

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SEASONS GREETINGS & BEST WISHES

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HAPPY, HEALTHY & PROSPEROUS 2008!

ESTATE PLANNING FOR EXXON VALDEZ CLAIMS

EXXON VALDEZ Claims. Do you or your client have a claim for damages resulting from the EXXON VALDEZ oil spill? If so, you know that the United States Supreme Court has granted certiorari to review the Ninth Circuit Court of Appeal's decision in this case. The Ninth Circuit awarded $2,500,000,000 of punitive damages, which together with interest now totals approximately $4,700,000,000. The United States Supreme Court is considering whether to uphold or reverse this award.

If a client has a claim which if successful would increase the client's net worth so that estate taxes would have to be paid at the client's death, then immediate estate planning should be considered. At the present time, the client's claim is significantly reduced in value, due to the pending review. While the value is reduced, estate planning can be accomplished which may substantially reduce the client's estate taxes in the future. However, the planning must be accomplished before the U.S. Supreme Court renders its decision. We are available to help you with this planning.

STATUS REPORT: REFORM OF FEDERAL ESTATE TAX LEGISLATION

2001 Tax Act. We are now seven years through the ten year lifetime of the 2001 Tax Act. As you will recall, when this Act was passed there were not enough votes to make it permanent. As a result, the Act will "sunset" in 2011. Under this Act, in 2008, the applicable exclusion amount (the amount that you can transfer tax-free at death) continues to be $2,000,000 and increases to $3,500,000 in 2009. In 2010, the federal estate tax is repealed for one year, and in 2011 the estate tax comes back into effect and the applicable exclusion amount is reduced to $1,000,000. During 2008 and 2009, once the exclusion amount is used, the tax rate is 45 percent. In 2011, the old graduated rate structure will come back into effect with a maximum rate of 55 percent.

Reform. Over the past seven years, Congress has attempted to make the estate tax repeal permanent. However, the changed fiscal situation and political makeup of the House and Senate has prevented permanent repeal.

Senate Finance Hearing. In November of this year, the Senate Finance Committee held a hearing concerning the status of the estate tax and heard testimony from panelists advocating various positions. Statements from senators on both sides of the isle made it clear that Congress is no longer considering repeal but is searching for a compromise among the parties that will allow for needed reform. Statements by Max Baucus, chairman of the committee, indicated that reform legislation would probably not occur until 2009, after the upcoming presidential election.

Types of Reform:

1. Applicable Exclusion Amount. The types of reform provisions discussed by the panelists and members of the Finance Committee may well indicate the type of compromise that will occur. An increased applicable exclusion amount of $3,500,000 to $4,000,000 was discussed. This amount would be indexed for inflation.

2. Small Businesses and Farms. There was considerable concern about small businesses and farms and the need for deductions or payment plans to avoid families losing these businesses because of the need to pay estate taxes. Such provisions have been enacted previously and some exist presently under the estate tax. Perhaps these provisions will become more generous under reform.

3. Rate. The maximum rate was of considerable concern to panelists discussing very large estates. Taxpayers with such estates are not so concerned about the applicable exclusion amount but rather would like to see a low maximum rate. Conversely, taxpayers with estates that would be protected by, for example, a $3,500,000 applicable exclusion amount are less concerned about a high maximum rate. In the past, discussions of the maximum rate have ranged between a low of 15 percent (the present capital gain rate) and a high of the existing 45 percent rate. Warren Buffett testified that he thought that large estates should be subject to an even higher maximum rate. One compromise rate that has been discussed is to set the maximum estate tax rate at the same percentage as the maximum income tax rate.

Compromise. It is always extremely difficult to predict federal tax legislation. Many different factors and influences are brought to bear when the final legislation is determined. However, we hope that Congress will be able to work out compromise reform estate tax legislation so that we will finally have certainty in this area. The worse case scenario would be if the political parties could not agree and the 2001 Tax Act is allowed to run its ten-year period, with one year of repeal, and then revert back to the $1,000,000 applicable exclusion amount and 55 percent maximum rate.

In summary, repeal is no longer a realistic expectation. The probability is that reform will occur in 2009. We should urge our legislators to work towards this goal.

ALASKA'S 2007 ESTATE AND TRUST LEGISLATION

LIMITED LIABILITY COMPANIES

Limited liability companies (LLCs) combine the corporate benefit of limited liability for all of the owners with the partnership benefit of flexible flow-through income taxation. Limited liability companies have become the preferred form of business organization in many states, including Alaska. In 2007, the Alaska Legislature enacted House Bill 195 which clarified and improved the use of LLCs both for small business and in estate planning. The new legislation makes it clear that professionals, such as doctors, lawyers, engineers, accountants, and other licensed professionals, can use an LLC as their business entity. While many professionals and their advisors have assumed that they could use LLCs, the Act was previously unclear.

In addition, Alaska's limited liability company statutes were amended in order to avoid adverse estate tax consequences when an LLC has co-managers, one of whom has all distribution and liquidation powers. Often, senior family members contribute assets to an LLC in exchange for membership interests. At times, a senior family member will desire to be a co-manager of the LLC in order to accomplish investment responsibilities. However, for Federal Estate Tax purposes, it is important that the senior family member not have powers over distribution or liquidation provisions. Nor should the senior family members have the potential right to participate in voting upon an amendment to the operating agreement which would change distribution and liquidation powers of a co-manager. House Bill 195 allows an operating agreement to be structured so that the senior family members do not have such disadvantageous powers. This amendment will facilitate the use of family LLCs by Alaska families for their estate planning.

ESTATES

Will Contests. Many individuals desire to place a provision in their will or trust that penalizes a beneficiary for contesting the dispositive provisions of the will or trust. The purpose of this provision is to avoid a costly will or trust contest after the individual dies. Existing Alaska law provides that a provision may be placed in a trust penalizing a person for contesting the trust even if probable cause exists for instituting proceedings. However, existing Alaska law does not allow a similar provision in wills. House Bill 196 would treat trusts and wills equally and allow such a provision in wills as well.

Life Insurance or Retirement Benefits: Asset Protection. In addition, this bill provides that life insurance or retirement benefits payable at death are not subject to the claims of the creditors of the individual who is insured under the life insurance contract or who was a participant in the retirement plan. This asset protection applies whether the benefits are paid to a designated beneficiary or to the decedent's estate.

House Bill 196 has passed the House and presently has been assigned to be heard by the Senate Labor and Commerce Committee. Hopefully this bill will be passed by the Legislature and signed by the Governor during the 2008 legislative session.

TRUST LEGISLATION

House Bill 197 and identical Senate Bill 146 provide the following valuable improvements to Alaska's trust legislation.

Professional Corporations. The bills allow shares of professional corporations to be owned by a revocable trust. This will avoid probate at the death of the professional.

Trustees. The bill also provides extensive provisions relating to the removal of trustees, compensation of trustees, acceptance of a trusteeship, co-trustees and their powers, vacancies of trusteeships and appointment of successor trustees, resignation and removal of trustees, delivery of property by former trustees, reimbursement and expenses incurred by trustees, and the certification of trusts.

Decanting Powers. In addition, improvements are proposed for Alaska's "decanting" statute. Alaska is one of a handful of states that has a special statute that allows trustees to solve trust problems by "pouring over" trust assets to a new trust that is designed to avoid such problems. The proposed amendments would provide this decanting power to trustees of trusts which have been moved to Alaska.

Charitable Trusts. The pending trust bills also improve charitable trusts in Alaska. Under existing Alaska law, a trustee of a trust established solely for charitable purposes may elect to calculate income and distributions based on a percentage of the value of the trust, determined on a yearly basis. The proposed amendments allow the trustee to select the percentage payout either annually or when the trustee deems such change necessary and prudent. The proposed changes also permit the trustee to determine the period of years over which the trust value would be averaged, even if the trust has not been administered as a unitrust in the prior years. The proposed change will ensure that purely charitable trusts are managed to maximize long-term growth of the trust and provide distributions to the charitable beneficiaries.

Intent to Protect Assets. Finally, these trust bills contain a provision designed to clarify that a settlor's expressed intention to protect trust assets from a beneficiary's potential future creditors is not evidence of an intent to defraud. Modern financial planning often involves setting aside a portion of a person's assets so that they are protected against potential future creditors' claims. Asset protection planning has become an integral part of the estate planning process. This amendment clarifies that a person's expressed intention or motive to accomplish asset protection planning is not considered evidence of an intent to defraud under Alaska' s fraudulent transfer statute.

House Bill 197 has been passed by the House and is presently awaiting hearing in the Senate Judiciary Committee. Similarly, Senate Bill 146 is pending hearing in the same committee. Hopefully, these bills will be approved by the Legislature and signed by the Governor in 2008.

UNIFORM DISCLAIMER OF PROPERTY INTERESTS ACT

House Bill 201 is a uniform law proposed by the National Conference of Commissioners on Uniform State Laws relating to disclaimers of property interests. Disclaimers are often used in estate planning in order to change where a property interest will go without having adverse tax or creditor impacts. A simple example would be a grandparent dying and leaving the property to her daughter. The daughter may decide that she does not need the property and disclaims it and, as a result, the property goes to the grandchildren.

This uniform act has already been the subject of a hearing by the House Judiciary Committee, and substantial input has been provided by estate planning practitioners. Further hearings are expected in 2008, and this Act may be enacted by the Legislature during that session.

GIFTING: IMPORTANT GIFT AND GST TAX RULES

Since we are in the midst of the holiday season, it is very appropriate for us to be thinking about gifting. When we make gifts, there are gift, estate, and generation-skipping tax consequences. The following is a summary of important fundamental tax rules which we should consider when making gifts.

Tax-Free Annual Exclusion Gifts. Each person (donor) may gift up to $12,000 to another person (donee) each calendar year. For example, donor could gift $12,000 to each child, grandchild, and friend(s) each calendar year. These gifts can be cash, property, or fractional interests in property.

In addition, tax-free annual exclusion gifts include the payment of any amount of tuition to an educational organization for the education or training of the donee. However, this exclusion does not apply for the payment of books, supplies, dormitory fees, board, or other similar expenses that do not constitute direct tuition costs.

An educational organization includes primary, secondary, prepatory, high schools, colleges, and universities.

Also, tax-free annual exclusion gifting allows an unlimited gift-tax exclusion for amounts paid on behalf of a donee directly to a provider for medical care. This exclusion is also available for payments for medical insurance paid on behalf of an individual. However, the exclusion does not apply with respect to medical expenses previously paid by the donee that are reimbursed by the donor nor does the exclusion apply to amounts paid for a donee's medical care that are reimbursed by the donee's medical insurance.

Annual exclusion gifts, described above, only are available for gifts of a "present interest" in property. A present interest is something that the donee can use right away. A gift to a trust is generally not a present interest unless the trust is drafted in a certain limited manner or unless "withdrawal rights" are provided by the trust instrument. We often use this withdrawal right approach. A beneficiary is given a right to withdraw the gifted property from the trust for a period of 30 days. If the beneficiary fails to withdraw the property, then the withdrawal right lapses. However, the courts have agreed that since the donee had the right to withdraw the property for a period of time, the gift is a "present interest."

The annual exclusion gifting of $12,000 per person per calendar year is a "use it or lose it" benefit. Each calendar year a donor has the ability to make these gifts but if the donor does not make them, then the donor cannot go back and use past years' gifting ability at a later date.

Applicable Exclusion Gifts. During 2008, each person has the ability to transfer up to $2,000,000 of property at their death tax free. One million dollars can be used during the person's lifetime for tax-free gifting. In 2009, the applicable exclusion amount increases to $3,500,000, but the $1,000,000 tax-free gifting amount stays the same.

To the extent that you use the applicable exclusion gifting during your lifetime, it reduces the amount of the exclusion available for use at your death.

Split Gifts. The tax-free gifting described above may be made by each spouse separately. Alternatively, the spouses can "split gifts". This means that one spouse can consent to allowing the other spouse to use the first spouse's gifting ability. As a result, gifts made by one spouse can be $24,000 per donee per year under the annual exclusion, and $2,000,000 using the spouses' applicable exclusions.

Marital Deduction Gifts. Gifts between spouses generally qualify for the marital deduction and, therefore, are tax free. However, the marital deduction does not apply to gifts to a non-citizen of the United States. (An increased annual exclusion is available for such gifts.) Further, certain types of property interests will not qualify for the marital deduction.

Charitable Gifts. There is an unlimited gift tax charitable deduction. This means that you may give any amount to qualifying charities and not have to pay any gift tax. However, only certain types of split interest gifts qualify.

Valuation. As discussed above, tax-free gifts to persons other than your spouse or a charity are limited to certain values. Some property is easy to value, such as cash or marketable securities. Other property, such as interests in closely held businesses or real estate may be difficult to value. Further, often discounts apply to gifts of fractional interests in property, interests in business entities such as corporations or limited liability companies, and other partial or difficult to value types of property. These discounts include minority interest discount, lack of marketability discount, and sometimes an entity discount.

Gift Tax Returns. Gift tax returns are not required for annual exclusion gifts, split gifts, marital deduction gifts, or charitable gifts. However, often it is desirable to file a gift tax return for annual exclusion gifts if the value of the gift is in question. Further, gift tax returns are required for gifts of applicable exclusion amounts and split gifts. The advantage of filing a gift tax return is that it commences a three-year statute of limitations. If the IRS fails to challenge the value of the gift during that period of time, then the IRS is foreclosed from ever challenging it in the future. In order for a gift-tax return to be effective to start the statute of limitations, it must adequately disclose the gift and its valuation.

Generation-Skipping Transfer Tax. Gifts to grandchildren and further descendants also come under the generation-skipping transfer tax. However, if a gift qualifies as an annual exclusion gift, then it is also tax free under the GST tax. In addition, each person has a GST exclusion amount that is the same as the applicable exclusion amount ($2,000,000 in 2008). This amount can be allocated to gifts and prevent them from being taxable under the GST tax. Such allocation is done on a federal gift tax return.

Tax Advantages of Making Gifts During Your Lifetime. As discussed above, the tax-free annual exclusion gifting is a "use it or lose it" tax-free benefit. By making gifts of annual exclusion amounts either directly to your choice of donees, or to trusts for their benefit, these amounts and their growth after the gifting will not be included in your estate and taxed at your death. Similarly, gifts of applicable exclusion amounts ($1,000,000) made during your lifetime, and all the growth of those amounts until your death, will not be included in your gross estate and taxed at your death.

In Alaska, we have the benefit of being able to use self-settled discretionary spendthrift trusts. These trusts allow a person to make gifts of annual exclusion amounts and applicable exclusion amounts to an irrevocable trust and the donor may also be a discretionary beneficiary of that trust. The result is that you can remove the gifted amounts and their growth from your gross estate, and those amounts are still available to be distributed to you if you need them during your lifetime.

Once you have used up your annual exclusion and applicable exclusion gifting abilities, there are other techniques available to transfer assets to trusts gift-tax free. One of the best approaches is a grantor retained annuity trust, which was discussed in our 2004 Summer Newsletter.

Before you do any significant gifting, it is wise to consult with your estate planning attorney. The summary of the rules provided above is by necessity an oversimplification. Further, there are procedures that are often necessary in order to either successfully accomplish the gifting or to implement and satisfy the IRS compliance requirements. We are available to help you with your gifting needs.

TAX-FREE DISTRIBUTIONS FROM IRAs TO CHARITY

There is still time for persons who are at least 70½ years old to take advantage of a special way to make charitable gifts. For two years, ending in 2007, persons who have reached the above age may take a distribution from their traditional individual retirement account (IRA) or a Roth (IRA), which would otherwise have been taxable, and contribute it to a public charity. If such a contribution is made, none of the distribution will be considered income to the IRA owner. The maximum amount which can be so distributed and contributed is $100,000 per taxpayer per taxable year.

The contribution must be made to a public charity, and donor advised funds do not qualify. Nor do distributions from employer-sponsored retirement plans, including SIMPLE IRAs and Simplified Employee Pensions (SEPs).

For individuals who desire to contribute part of their IRAs to charity, this is a very beneficial provision. Without this provision, the entire distribution (for example, $100,000) would first be ordinary income to the individual. Then, the individual's income tax charitable contribution might well be limited by other income tax provisions so that only part of the contribution would qualify for the income tax charitable deduction.

Again, if you desire to take advantage of this provision, you must do so before the end of 2007.

OUR STAFF AND THEIR ACTIVITIES

In August, attorneys from the Western Region of the American College of Trust and Estate Counsel met in Anchorage for a three-day conference. ACTEC members from the Western states, and even a few visitors from the East Coast, attended for continuing education seminars and to visit our great state. A very successful salmon fishing day was experienced in Resurrection Bay. Dave presented a paper on "Domestic Asset Protection Trusts: Issues and Answers."

Dave has continued to publish articles regarding Alaska estate planning in national estate planning periodicals. In May, Dave published an article on "Defined Value Clauses" (that can be used to cap gift tax exposure) in TRUSTS & ESTATES magazine.

In March and April 2008, ESTATE PLANNING magazine will publish a two-part article edited by Dave which compares the now eleven state domestic asset protection trust statutes.

Bhree, who has two little girls (Emma and Elizabeth) has remarried. Her new spouse, Rob, also has two girls (Larissa and Amber).

We have **two new legal assistants**, Ann Webster and Tonya Stanley.

Ann is originally from San Luis Obispo, California. She obtained her B.A. in Business Administration from Arizona State University at Tempe. She is a certified debt counselor and prior to joining our firm was branch manager for a debt counseling service in Anchorage.
Ann assists with both probate and trust administration and with the implementation aspects of estate and business planning projects.

She enjoys time with her grown children. Ann and husband Mike enjoy mountain biking, travel, and the Boston Red Sox. Ann enjoys the outdoor life Alaska offers.

Tonya was born in Anchorage and moved to Texas at the age of ten. She received her A.A. degree in Legal Administrative Assisting in April 1995 in Dallas, Texas. After receiving her associates degree, she worked for a background investigation company. Tonya has been working as a legal assistant since 2000. She has seven years experience as a bankruptcy paralegal working on a contract basis for numerous debtors' attorneys, creditors' attorneys, and trustees. In 2005, she returned to college and majored in business management. She moved back to Alaska in 2007 to spend more time with her family.

She works with our clients in the implementation of their estate and business planning projects.

OUR WEB SITE

You may refer to our website for a variety of information:
1. A "what's new" discussion of developing estate planning subjects;
2. New federal and state legislation affecting estate planning;
3. A "checklist" for evaluation of your estate planning;
4. Discussion of a number of relevant estate planning techniques;
5. Our past newsletters;
6. Key Alaska estate planning statutes; and
7. Many articles which we have written about Alaska estate planning techniques.

We hope you will visit our web page at your convenience.

Please e-mal us at <**info@shaftellaw.com**> with your estate planning questions or topics which you would like to see discussed on our web site.

We hope the above information is helpful to you. We remain available to help you create and maintain your estate planning and to add appropriate new techniques when you so desire. If you would like to meet with one of our staff to discuss your planning, please call.

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