

ALERT

Volume VIII, No. III

April, 2008

ESTATE PLANNING NEWSLETTER

ESTATE TAX REFORM

In 2001, Congress enacted the current federal estate and gift tax law, known as the Economic Growth and Tax Relief Reconciliation Act of 2001. Over the past seven years, the federal estate tax exemption (the amount of property that an individual can pass free of federal estate tax) has risen from \$675,000 to its current level of \$2 million per individual or \$4 million per couple. During the same period, the maximum federal estate tax rate declined from 55% to 45%.

In 2009, the federal estate tax exemption will rise to \$3.5 million per individual and \$7 million per couple and in 2010 current law provides for complete repeal of the federal estate tax. These changes, however, are not permanent and in 2011 the federal estate tax will return to its old estate tax exemption amount of \$1 million with a maximum federal estate tax rate of 55%.

The uncertainties of the present estate tax law have complicated efforts to plan for a tax efficient distribution of wealth. During the past few years, a number of unsuccessful attempts were made to obtain permanent estate tax reform. Most Republicans supported a permanent repeal of the estate tax, whereas Democrats opposed permanent repeal. In the

current political environment, permanent estate tax reform will most likely require a compromise plan.

A number of reform bills that have passed the House illustrate how a permanent estate tax compromise might look. In one bill, the estate tax exemption was increased to \$5 million per individual (\$10 million per couple) coupled with substantially lower estate tax rates. Another bill contained a phased increase of the estate tax exemption from \$3.5 million to \$5 million per individual, with an estate tax rate starting at the current long-term capital gains rate for estates that exceed the exemption amount. Despite these efforts, the Senate failed to approve either bill.

A complete repeal of the estate tax seems highly unlikely. However, proposed legislation and statements by party leaders suggest that a compromise might be achieved with an estate tax exemption somewhere between \$3 million and \$5 million per individual (\$6 to \$10 million per couple), along with federal estate tax rates that are somewhat lower than the current rate of 45%.

It continues to be important to have an estate tax plan that takes into account the uncertainty ahead and to meet personally with attorneys and tax advisors to ensure the plan's ability to accomplish its desired goals.

(continued)

THE IRREVOCABLE LIFE INSURANCE TRUST

Few people realize that their heirs may owe substantial estate taxes because they own a life insurance policy with a substantial death benefit. This is so because life insurance proceeds, while not subject to federal income tax, are considered part of the taxable estate and are subject to federal estate tax.

The Irrevocable Life Insurance Trust (ILIT) can be used by an individual with a need for insurance, so that the proceeds pass free of estate tax. An ILIT is an irrevocable trust created to own the insurance policy as a separate entity. If the ILIT is structured correctly, the insurance proceeds will not be included in the taxable estate of the insured.

Generally, an ILIT is used where there is a need for life insurance (for example, where the insurance will generate funds to pay estate taxes or other expenses; fund the buyout of business interests; or increase the size of the insured's estate) and when it is advantageous to keep that amount out of the decedent's estate for estate tax purposes. While life insurance proceeds are ordinarily added to the taxable estate of the insured owner upon death, creating an ILIT to own the insurance policy can remove the insurance from an individual's taxable estate. Additionally, a trust provides an effective and flexible tool for managing and distributing the insurance proceeds to a surviving spouse or other beneficiaries of the ILIT.

In the most common situation, the ILIT is used to prevent the life insurance proceeds from being taxed as part of the estate and to ensure that the spouse or the descendants enjoy the benefits of the insurance. For example, structured properly, a surviving spouse could be entitled to all or a portion of the income of the trust or to trust principal, without causing the trust to become part of the surviving spouse's taxable estate. Alternatively, the surviving spouse could be given the power to remove the greater of \$5,000 or 5% of the value of the trust annually, without subjecting it to tax in his or her estate. There are many other scenarios in which an ILIT can be used to pass insurance proceeds in a tax efficient manner.

Under the proper circumstances, an ILIT can be an effective estate planning tool to minimize tax and provide for the effective management of assets. In order to fully utilize the ILIT, a client's objectives must be carefully considered in conjunction with the estate and gift transfer taxes arising as a result of the investment. If you own a life insurance policy with a significant death benefit, an ILIT may be of substantial benefit.

Authored by Thomas G. Blomberg, Esq.

Thomas Blomberg focuses his practice on estate and tax planning for individuals and closely held businesses, administration of estates and trusts, and related litigation. For further information, please feel free to contact Mr. Blomberg at (925) 944-9700.

The summary which appears above is reprinted for informational purposes only. It is not intended to be and should not be considered legal advice nor substitute for obtaining legal advice from competent, independent, legal counsel. If you would like to discuss these matters in more detail, please feel free to contact us so that we can provide the clarification and resources you need to make effective decisions.

Circular 230 Disclosure:

Pursuant to rules and regulations imposed by the Internal Revenue Service, any tax advice contained in this communication, including any attachments, is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding tax penalties under the Internal Revenue Code or (2) promoting, marketing or recommending to another person any transaction or matter addressed herein.