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Client Advisory

2006 Year End Estate Planning Review

December 2006

There were many developments over the year affecting estate planning on the national, local and international levels. The Trusts and Estates Department at Katten Muchin Rosenman LLP is pleased to provide you with a summary of some of the most significant developments, along with recommendations for you to consider at year end and for next year.

Estate, Gift and Generation Skipping Tax Rates

The top estate tax rate will drop from 46% to 45% on January 1, 2007. The rate will stay at 45% until 2010. In 2010, current law calls for the estate tax to be repealed, making the estate tax rate 0% for 2010. In 2011, current law calls for the estate tax to return, with a top rate of 55%.

The top gift tax rate is scheduled to fall based on the same schedule. However, during repeal of the estate tax (if it happens, scheduled to take place in 2010), certain gifts will remain subject to tax at the top individual income tax rate. Under the income tax rate reduction schedule provided by applicable law, the top individual income tax rate after 2006 will be 35%. However, in 2011, the top gift tax rate will return to 55%, like the estate tax rate.

Also, the generation-skipping tax is equal to the maximum estate tax rate. Therefore, as the estate tax rates change, the generation-skipping tax rates will change as well.

Estate, Gift and Generation-Skipping Tax Exemptions

The exemption from the estate tax, called the "applicable exclusion amount," will be the same in 2007 as it was in 2006 — $2,000,000 per person. In 2009 the exemption is scheduled to increase to $3,500,000. In 2010, under current law, the estate tax is to be repealed — meaning that the exemption in 2010 will be unlimited. In 2011, the estate tax is to return with an exemption equal to $1,000,000.

The amount you can gift during your lifetime using your gift tax applicable exclusion amount without paying gift tax is *frozen at $1,000,000*. Even in 2010, when there is no estate tax, the gift tax applicable exclusion amount remains frozen at $1,000,000.

The generation-skipping tax exemption, which was $2,000,000 in 2006, will remain at that level for 2007. It will track the increase in the estate tax applicable exclusion amount until 2009. In 2010, the generation-skipping tax exemption will be unlimited. In 2011, the generation-skipping tax exemption is to return to $1,000,000 with an annual inflation adjustment.

Annual Gift Tax Exclusion

Persons are entitled to make gifts of the "annual gift tax exclusion amount" without incurring gift tax or using some of their lifetime exemption against estate and gift tax. This amount was $12,000 per donor per recipient in 2006.

If inflation is sufficient, that amount is adjusted upwards; however, this year's inflation figures were not high enough to push the exemption amount any higher than in 2006. Thus, for 2007 the annual gift tax exclusion amount remains at $12,000 per donor per recipient.

Note that for gifts made in 2007 there was an increase in the amount of the annual gift tax exclusion with respect to gifts made to non-citizen spouses. That amount increased to $125,000 from the 2006 level of $120,000.

A Look Into The Crystal Ball – What Will Happen To The Estate, Gift and Generation-Skipping Tax in 2010 and Thereafter?

Congress tried many times to repeal the estate tax in 2006, to no avail. Recognizing that repeal cannot be accomplished, Congress is now entertaining proposals to increase the estate tax exemption and to reduce the estate tax rate.

Proposals to increase the exemption have ranged from a freeze at the 2009 $3,500,000 amount to an increase in the exemption up to $7,000,000 per person. Most recent proposals seem to focus on a $5,000,000 exemption (which, if passed, would mean that married couples with properly planned estates could pass $10,000,000 to their children without incurring estate tax).

Proposals to reduce the estate tax rate have ranged from 15% - 40%. Most recent proposals suggest a 25% - 35% top bracket. For large estates, a significant reduction in estate tax rate will provide significant estate tax savings.

Pension Protection Act of 2006 Estate Planning Related Changes

The Pension Protection Act of 2006 included a number of changes that are of interest to estate planners. Those changes are summarized below:

- Charitable Contributions from IRAs

  For 2006 and 2007, charitable contributions can be made directly from IRAs to public charities. The advantage of this alternative is that those gifts can be made directly to charity without having to first take the money out of the IRA, include it in gross income, and then make the gift to charity. This approach avoids the possibility that a portion of the charitable deduction will be lost because of the "percentage limits" on the deductibility of gifts to charity for income tax purposes.

  To qualify for this option, the donor must be at least 70-1/2. The gift must be made to a public charity, which excludes gifts to donor advised funds and supporting organizations, though gifts to "conduit" private foundations are permitted. The maximum amount that can be given to charity using this approach is $100,000 per year.

  Any gift to charity under these provisions will also count towards the minimum distribution requirement for the year of distribution.

- Rollovers Permitted for Non-Spouse Beneficiaries of Employer Plans

  Certain employer retirement plans require either a lump sum distribution to beneficiaries or a maximum 5 year payout. A beneficiary receiving distributions from such plans is therefore required to receive and pay income tax on distributions within a short period of time, which also limits the period after the participant's death where assets can remain in the plan to continue to grow income tax-free.

  Current law allows a spouse to "rollover" any lump sum distribution from a plan. The benefits of the rollover are that the surviving spouse can take distributions over his or her life expectancy, thereby deferring income tax, and allowing the assets to remain in a rollover IRA where they can continue to grow income tax-free.

  The Pension Protection Act now allows non-spouses to rollover distributions from employer plans to avoid the income tax disadvantages of a lump sum or 5 year payout. Though the non-spouse beneficiary will be required to begin taking distributions immediately (a spousal rollover allows the spouse to defer distributions until he or she attains age 70-1/2), payments can be spread out over the non-spouse beneficiary's lifetime. The treatment is similar to that of an "inherited IRA".

  These rules apply for a beneficiary who begins taking distributions after December 31, 2006. Therefore, some beneficiaries are postponing the start of distributions until next year.

- Reporting Requirements for and Treatment of Certain Charitable Contributions Changed

  If tangible personal property worth more than $5,000 is contributed to a charity that is sold by the charity within 3 years of the contribution, the donor must reduce or recapture the amount of his charitable deduction if the sales price is less than the amount of the deduction taken.

In order to eliminate charitable deductions for gifts of worthless, broken, or essentially valueless items, clothing and household items given to charity will only be deductible if they are in "good used condition" and have more than a minimal monetary value.

For 2006 and 2007, gifts by S corporations to charity will reduce the shareholder's basis in his S stock only by the value of the contributed property's basis. Previously, basis was reduced by the fair market value of the item contributed.

A number of new rules were enacted to apply to donor advised funds. New taxes are imposed on "taxable distributions" from donor advised funds. These types of distributions include payments to some supporting organizations and payments to non-qualified charities. Other new taxes are imposed on distributions from donor advised funds that allow for more than "incidental benefits" to the donor, donor advisors, or related persons. The "excess business holdings" tax will be applicable to donor advised funds, requiring the disposition by the fund of closely-held business interests within 5 years of receipt if more than 20% of the business is owned by the donor and related parties. Finally, a new special tax is imposed on donor advised funds that make distributions (including grants, loans or compensation) to donors, donor advisors, or related persons.

In addition, the rules applicable to "supporting organizations," particularly "Type III" organizations, have been tightened. A Type III supporting organization is one where the supported charity simply approves the managers of the supporting organization, and has been used and operated in a manner similar to a private foundation while still providing most of the benefits of a public charity – an approach seen as having great potential for abuse by the IRS. For example, distributions from private foundations to certain supporting organizations will no longer satisfy a private foundation's minimum distribution requirements. Donor advised funds of many Type III supporting organizations are no longer recognized and, in general, the rules make it harder to qualify a Type III supporting organization for tax exempt status.

- New Limitations on Charitable Gifts of Fractional Interests in Tangible Property & Recapture Rules

Gifts of partial interests in tangible property may no longer be an attractive method of charitable giving. Limitations on the deductible value of fractional interests in tangible property were made effective August 17, 2006. As in the past, if a gift of a fractional interest in tangible property is made to a charity in Year 1 and the use of the property by the charity is related to such charity's exempt purposes, the deductible value of the taxpayer's contribution will be the fair market value on the date of contribution. However, pursuant to the new rules, the deductible value of any fractional gifts of the same tangible property made in future years will also be determined as of the date of the initial Year 1 contribution if the Year 1 value is lower than the fair market value on the date of subsequent contributions. This effectively prevents taxpayers from realizing a charitable deduction on the appreciation in the value of the property upon subsequent fractional gifts. Further, the new rules require that 100% of the property must be received by the charity within the earlier of 10 years or the donor taxpayer's death. Failure to do so will result in the recapture, with interest, of income and gift tax charitable deductions and the imposition of a 10% recapture penalty.

- Valuation Penalties Increased and Application Expanded

A substantial valuation misstatement penalty is imposed if estate or gift tax is underpaid by more than $5,000 and the value claimed on the return is from 65% to 40% of the "correct value", a 20% penalty tax is imposed on the estate or gift tax arising from the undervaluation. Prior to the Pension Protection Act, the penalty did not apply unless the value claimed on the return was from 50% to 25% of the correct value.

If the return shows only 40% or less of the "correct value", the gross valuation misstatement penalty applies. That penalty tax is 40% of the amount of estate or gift tax arising from the undervaluation. Prior to the Pension Protection Act, the penalty did not apply unless the value claimed on the return was 25% or less of the correct value.

Reasonable cause no longer protects taxpayers from these penalties. The penalties apply to returns filed after August 17, 2006.

In addition, appraisers can now be subject to penalties, though these penalties apparently apply only for underpayments of income tax. The penalty is equal to the greater of $1,000 or 10% of the underpayment attributable to the valuation misstatement, but not to exceed 125% of the amount the appraiser was paid for his services. It applies where there is a substantial or gross valuation misstatement, and the appraiser knew or should have known that the appraisal would be used in connection with a return.

- 529 Plans, which were scheduled to sunset, were made permanent by the Pension Protection Act.

- 529 Plan Abuses Addressed

  529 Plans provide a method by which taxpayers can set aside funds for college education that grow income tax-free, and if funds withdrawn are used for college, no income tax is ever paid on those funds. Though of great benefit when used legitimately, Congress perceives two abuses of 529 Plans – and the Pension Protection Act authorizes IRS to write regulations to curb those abuses.

  The first abuse is where a donor creates 529 Plan accounts for a number of beneficiaries (e.g., children and nieces and nephews), funding those accounts with gifts that qualify for the annual gift tax exclusion. Thereafter, as permitted under the 529 Plan rules, the donor changes the beneficiary on all the accounts to be the donor's children. The result is that the donor is able to fund the accounts for children using the annual gift tax exclusions, in this example, for his nieces and nephews.

  The second abuse is where a donor establishes a 529 Plan account for beneficiaries that may attend college, and then later changes the beneficiary of the account to be the donor. The donor is then able to withdraw the funds that have grown income tax-free with only a 10% penalty (and income tax on the withdrawn funds). The effect is to allow what is, in essence, an additional retirement plan account for the donor, at the cost of only a 10% penalty. In cases such as this one, the cost is seen as minimal compared to the benefits of income tax deferral.

  We will inform you of future regulations drafted to curb these perceived abuses once published pursuant to this authority set forth in the Pension Protection Act.

Family Limited Partnerships

Family Limited Partnerships ("FLPs") serve as a vital strategy for families of significant wealth to consolidate the management and investment of assets, to provide a vehicle for resolution of family issues regarding investment and control and to provide for a creditor protection vehicle. By consolidating the investible wealth of a family in an FLP, the FLP will more easily qualify as an accredited investor and as a qualified purchaser. FLPs are controlled by their general partner. This permits a family to vest in the appropriate entity or person the ability to make all day-to-day decisions regarding the partnership. The limited partners are mere investors and cannot exert control over the decisions of the FLP.

These business reasons have made FLPs popular with a number of our clients. Since limited partners cannot exert control over the decisions of the FLP, this has the effect of reducing the value of the limited partnership interest even upon creation of the FLP. Most clients are willing to accept this depressant valuation effect because they believe that the reasons for establishing the partnership in the first place (i.e., the consolidation of investments, creditor protection, etc.) will outweigh the valuation effect and over the long term more value will inure to all of the partners than if the partnership structure was not implemented.

However, some taxpayers over the past several years have attempted to use FLPs in ways they were not initially intended. Some taxpayers have been attempting to use an FLP as a testamentary substitute or utilizing partnership assets for their own benefit and then argue that they are entitled to the valuation discount associated with the limited partnership interests, as discussed above. Obviously, the IRS is attacking these types of FLPs because they believe that the structure itself lacked any business purpose. Where the partnership entity has not been respected the IRS has been and will continue to be successful.

In 2006, as in recent years, the IRS has been gaining ground in arguing that FLPs which lack business substance (or a business purpose) should be disregarded. They are focusing their efforts in this regard on FLPs which were administered poorly, where the taxpayers disregarded their own form and continued to utilize the FLP as their own "pocketbook." The IRS looks at factors such as payment of bills and other personal expenses, disproportionate distributions to partners (especially the patriarch or matriarch of the family), implied arrangements among family members to keep the patriarch or matriarch with the same income stream and where the FLP was funded with most of an individual's assets.

The IRS has been unsuccessful in disregarding partnerships which have a business purpose (or a non-tax purpose) and which are administered properly. It is critically important that clients with FLPs have appropriate counsel to discuss any potential distributions from a partnership and generally discuss issues regarding administration of the partnership. Where these formalities have been followed, taxpayers continue to enjoy the benefits of utilizing an FLP – both the business and tax advantages.

"Kiddie Tax" Changes

Children are generally in lower income tax brackets than their parents. Recognizing that difference, parents attempt to reduce income taxes on investment earnings by shifting assets to children and allowing them to invest those assets and pay less tax on the income earned than if their parents invested those assets.

To minimize this opportunity, Congress passed the "kiddie tax" a number of years ago. That tax required children under the age of 14 to pay income tax on their investment income at their parents' tax rates. The kiddie tax laws were amended to require children under the age of 18 to pay income tax on their investment income at their parents' rates, beginning in 2007.

Private Annuity Sale – Income Tax Changes

Taxpayers wishing to sell real property that generated a taxable gain have always had the option of "rolling that gain over" under Section 1031 of the Internal Revenue Code into a replacement property, effectively deferring the tax on that gain. However, taxpayers currently believe that real estate prices may fall, and therefore are less willing to roll over their gain into other properties within the time limits required to qualify for Section 1031. As a result, taxpayers sought other options to defer gain beside Section 1031.

One option that many real estate brokers identified for their prospective sellers was a "private annuity sale". Using this transaction, the (parent) seller would sell his or her real property to the children in exchange for a private annuity contract. Under the law then existing, the purchaser children received a "full" basis in the property and could then sell the property to a third party without having to recognize gain. The seller parent received annuity payments from the children over time, with each payment treated as part ordinary income, part capital gain, and part return of basis. A deferral similar to the deferral under Section 1031 was therefore accomplished, without requiring the investment of the sales proceeds in a replacement property.

The IRS disliked this approach because it allowed the children to receive an increased basis without the parent having to recognize gain. Therefore, the IRS proposed amendments to Treasury Regulations that would eliminate this option. Under the proposed regulations, when the parent receives his or her annuity contract in exchange for the property sold to the children, the parent will be treated as having sold the property for cash. The parent will recognize the gain. Then, the parent will be treated as investing that cash in the annuity (with the effect of eliminating that portion of each annuity payment treated as capital gain under old law).

These proposed regulations, if adopted, apply to private annuity contracts entered into after October 18, 2006. Payments received after that date under contracts entered into prior to that date will be "grandfathered" from this new tax treatment. In addition, if a taxpayer receives an annuity contract issued by an individual (i.e., not a trust) before April 18, 2007, and the property is not re-sold by the purchaser children before a date two years after the initial sale, the tax treatment available to such taxpayer will also be as under old law.

Private annuity sales still can make sense in the estate planning context, and the rules were specifically made inapplicable to charitable "gift annuities" issued by public charities. However, due to these changes, even in the estate planning context private annuity sales become less attractive when compared to similar alternatives like "self-canceling installment notes".

Pre-Pay School Tuition Without Gift Tax

Payment of tuition directly to a school is not treated as a gift for gift tax purposes, no matter the amount of that tuition. Clients have used this exception to the transfer tax rules to reduce their taxable estates by paying tuition for children and grandchildren (if not others as well).

We have counseled our clients that the exception is not limited to the payment of tuition only for the year that the payment is made; future years' tuition can also be paid without gift tax. This technique can be very successful if a family member is close to death and wishes to reduce his or her estate for tax purposes. If that person pre-pays tuition for his or her children or grandchildren in private school or college, a significant amount can be removed from that person's estate without tax.

This year, an IRS ruling validated that approach, ruling for the first time that the exception for tuition payments applied not only to present years' tuition but also tuition due in future years.

Many institutions know of this approach and will provide the paperwork necessary to pre-pay tuition. Schools differ on whether or not pre-payment avoids future tuition increases (not a significant amount for tax planning purposes, but a "side benefit" if the tuition increases can be avoided using this technique) Note that in all circumstances the school keeps the monies paid, even if the student drops out of school.

Year-End Checklist For 2006

Set forth below are a number of suggestions you might consider for year-end gift and estate tax planning:

- Make year end annual exclusion gifts of $12,000 ($24,000 for a married couple).
- Create 529 Plan accounts before year-end for children and grandchildren, and consider front-loading the accounts with 5 years worth of annual exclusion gifts, taking into account any gifts made during the year to children and grandchildren.
- Pay tuition and medical expenses directly to the school or medical provider.
- Consider making charitable gifts before year end to use deduction on 2006 income tax return.

Planning Ideas For 2007

Set forth below are a number of estate tax planning ideas that you might consider in 2007.
Please consider the following ideas:

Gift Residence or Vacation Home Using Qualified Personal Residence Trusts

A discounted and leveraged gift of a residence is possible using a Qualified Personal Residence Trust ("QPRT"). After the gift, the donor can continue to reside in the residence until the QPRT ends, and even thereafter if proper planning is undertaken.

This planning is most effective when the value of the residence to be given is "low" and interest rates are "high". As housing prices drop across the country while interest rates rise, the economic environment for QPRT planning is becoming more favorable. As a result, QPRT gifting is an important alternative to consider in 2007.

Alternatives to Section 1031 Exchanges: Gifts to Charitable Remainder Trusts

Many taxpayers owning certain kinds of appreciated real estate sell that property and "rollover" the gain using Section 1031 of the Internal Revenue Code into another property – using this "like kind exchange" to defer income taxes. However, the economy is such that taxpayers desiring to sell properties now are finding it harder to find properties to purchase to accomplish this rollover. Therefore, we now find that taxpayers are seeking alternatives to like kind exchanges.

An option to consider is a gift of the property to a charitable remainder trust, retaining for life a payment equal to 90% of the value of the gifted property. The parent-donor also is allowed an income tax deduction equal to a portion of the gifted property (in the case where 90% of the value is retained by the parent in the form of lifetime payments, the deduction is equal to 10% of the value of the gifted property).

When the charitable remainder trust sells the property it recognizes no gain or loss. When the donor-parent receives payments from the charitable remainder trust, part will be taxed as income, part as capital gain, and (potentially) part will be treated as a distribution from principal of the trust and not taxable at all.

When the donor dies, the charitable remainder trust can pay over to the donor's family foundation, allowing the children to use those funds to accomplish the family's charitable goals.

Consider Buy-Back of Appreciated Low Basis Assets from Grantor Trusts

Some clients sold or gave (through a grantor retained annuity trust) an asset that was expected to appreciate in value. The tax planning idea that motivated them was to pass that appreciation on to trusts for their children without gift or estate tax. The children's trust that ends up owning the asset typically has a very low basis, meaning that a significant capital gains tax will be due if the trust sells the appreciated asset.

Where those plans succeeded, that appreciated asset now sits in a defective trust for the children. That grantor trust has a low basis in the asset. If the client purchases the asset back from the grantor trust for fair market value, no gain or loss is recognized. The trust now holds cash equal to the value of the appreciated asset that was repurchased, leaving the same amount to escape estate tax.

The advantage is that, on the client's death, the purchased asset will be included in the client's taxable estate and will receive a step-up in basis equal to fair market value. This means that the capital gains tax on sale of that asset is eliminated. The children benefit from the grantor trust's cash – and each dollar of cash has a dollar of basis – so truly the capital gain is eliminated forever.

International Considerations

A number of changes to the law affecting those in the international community occurred this year, including the following:

Now More Difficult to Abandon US Citizen or Resident Status for Tax Purposes

As a reminder, several years ago Congress made it much more difficult for citizens and long-term residents of the United States to abandon their citizenship or residency for the purpose of avoiding taxes. The new law, which is being strictly enforced by the Internal Revenue Service, applies without regard to the subjective intent behind expatriation.

The new law provides:

- Absolute standards for determining whether former citizens or former long-term residents are subject to the expatriation tax regime;
- Imposition of full U.S. taxation in any year for individuals who are subject to the expatriation regime and who return to the United States for more than 30 days such year;
- Imposition of U.S. gift tax on gifts of stock of certain closely held foreign corporations that hold U.S. situs property; and
- Annual return filing requirement for individuals who are subject to the expatriation regime.

The new standard for determining whether an individual who expatriates is subject to the expatriation regime is simple: if the average annual net income tax of such individual for the period of 5 taxable years ending before the expatriation is greater than $124,000 (indexed for inflation), the net worth of the individual as of such date is at least $2 million, or such individual fails to certify under penalties of perjury that he or she has complied with U.S. tax obligations for the preceding 5 years or fails to submit evidence of such compliance, such individual will be subject to the expatriation regime. There is no longer a presumption of tax avoidance motive that may be overcome.

In addition, an individual who expatriates will still be taxed as a U.S. citizen or resident until such individual gives notice of an expatriating act or termination of residency to the Secretary of State or Secretary of Homeland Security and provides a statement to the IRS, including details concerning the assets, income and liabilities of such individual. The new law applies to individuals who relinquish citizenship or terminate residency after June 3, 2004.

There are exceptions to the application of the expatriation regime if an individual is a dual citizen and has no "substantial contacts," and there also is an exception for certain minors. While expatriation still remains a viable option, it now requires significant advance planning and may have negative immigration (i.e., reentry) repercussions.

U.S. and France Amend Treaties

The United State and France have ratified a Protocol amending the Income Tax Treaty and the Estate and Gift Tax Treaty between the two countries. The Protocol provides a limited U.S. estate tax marital deduction where a surviving spouse is not a U.S. citizen, provides a pro rata unified credit to the estate of an individual domiciled in France (other than a U.S. citizen) for purposes of computing the U.S. estate tax due, and increases the ability of the United States to tax U.S. citizens and expatriates.

UK Rules Change Regarding Inheritance Tax Treatment of Trusts

The United Kingdom's Finance Act of 2006 has brought with it important changes to the Inheritance Tax treatment of trusts. With certain exceptions, lifetime trusts or trusts established on the death of a decedent will be subject to periodic charges and to an exit charge upon distribution. In light of this, it is more important than ever to adequately plan for individuals who expect to be domiciled or "deemed domiciled" in the UK and for non-UK domiciliaries with assets in the UK.

State Specific Considerations

Discussed below are a number of state law changes that you might consider along with the Federal tax planning ideas mentioned above:

California

California passed a number of laws (found throughout the Business and Professions Code and the Probate Code) intended to protect elderly persons subject to conservatorship from wrongdoing by their conservators. Provisions include licensing requirements for professional conservators, requirements of an initial six month accounting and yearly accountings thereafter, limits on the appointment of ex parte conservators and the requirement of a court investigator's report within 48 hours of the appointment of a temporary conservator, tougher bond requirements, and limits on fees to be awarded in certain matters. These changes take effect July 1, 2007.

In addition, a law was adopted to permit disposition of personal property under a writing referred to in a will, rather than requiring the disposition to appear in the will itself and/or requiring that the writing be in existence at the time the will is executed and incorporated by reference in the will. This procedure can be used for items worth $5,000 or less with a total value of no more than $25,000. It also provides the format for a writing that will qualify for this treatment.

New York

Important changes applicable in New York are summarized below:

- The Not-For-Profit Corporation Law has been substantially revised to facilitate the non-judicial termination of private foundations, where appropriate.
- The after-born child statute has been amended to require that in order for a child born after the death of his or her parent to be able to take a share against a will that makes no provision for him or her, the child must have been in gestation at the time of the parent's death.
- Guardianship of children may now continue, with the consent of the child, from 18 to 21 years of age.
- The statutory form by which one may make binding provision for the disposition of one's remains has been revised, and clients who have such directions in place should probably update them.
- New Yorkers will now be given the option of registering with the New York State Organ and Tissue Donor Registry when they renew their drivers licenses, in order to record their consent to making an anatomical gift at the time of their deaths.

Illinois

An amendment to the Illinois Disposition of Remains Act now causes an agent named under an Illinois Power of Attorney for Health Care as the "second in line" (after any person named pursuant to a Declaration under the Disposition of Remains Act) as the person with the power to direct the disposition of a decedent's remains.

North Carolina

One of the expenses incurred in the administration of a decedent's estate is a fee, based on the size of the probate estate, paid to the court. The basic fee is $40 plus $.40 per $100 (or $4 per $1,000) of value of the assets subject to probate, limited by a cap. Effective late last year, the maximum fee that could be charged by the court was increased from $3,000 to $6,000. This increase impacts probate estates whose value falls between $740,000 and $1,490,000. The increase will be nominal for most affected estates, but it serves to illustrate that probate fees are not terribly significant in North Carolina as compared to some states, which do not provide for such a cap on the fee. However, there can be other significant costs involved in an estate administration, such as fees paid to the personal representative and attorney, as well as procedural delays in the disposition of assets and potentially unwanted publicity regarding the estate. For those reasons, many of our clients consider structuring at least a portion of their assets to keep them out of the probate process, such as by contributing such assets to a funded Revocable Trust during their lifetimes.

Florida

In 2006, Florida repealed its intangibles tax, effective January 1, 2007. Going forward, Florida residents will no longer have a state estate, gift, income or inheritance tax.

Connecticut

Connecticut revised its health care directives and living will forms as of October 2006. Clients who have these documents should probably update them.

In addition, Connecticut revised laws pertaining to its gift and estate taxes:

- Connecticut has its own gift tax. Previously, no additional state gift tax could be assessed after three years had run from the filing or due date of the gift tax return (absent willfully false or fraudulent actions). Now, under the new statute and much like the equivalent federal statute, Connecticut residents must "adequately disclose" gifts on a Connecticut gift tax return to start the statute of limitations running. Otherwise, the Connecticut tax authorities can assess a gift tax at any time.
- Gifts made to parties in a civil union recognized under Connecticut law will have the same gift tax treatment as married persons for any gifts made after January 1, 2006. Similarly, the Connecticut estate tax treatment of parties in a civil union recognized under Connecticut law will mirror the treatment of married persons.

We Can Help

We hope that this Advisory helps you with your year end estate and gift tax planning, and also provides you with some interesting ideas to consider for the future. As always, the Trusts and Estates Practice stands ready and able to assist you with these matters at any time. Please do not hesitate to query any of us using the below contact information:

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