December 2009

2009 Year-End Estate Planning Advisory

The year 2009 was marked by many changes affecting estate planning and related areas on the local, national and international levels, against a backdrop of continuing uncertainty as to how—or if—the federal estate and gift tax applicable exclusion amounts and rates may change for 2010. The Trusts and Estates Practice at Katten Muchin Rosenman LLP is pleased to provide you with a summary of some of the most significant developments from the past year and expected future developments, along with recommendations for you to consider for year-end.

Where Will the Estate, Gift and GST Tax End Up in 2010?

If current law remains unchanged, in 2010 there will be no estate tax and no generation-skipping transfer ("GST") tax, so that you may leave an unlimited amount to anyone free from those tax regimes. Under current law, in 2011 the estate and GST taxes are scheduled to return, with only a $1 million applicable exclusion amount for each (indexed for inflation in the case of GST tax exemption). It is widely expected that this result will not be allowed to occur, yet here we are in December, with no new legislation to resolve the issue of where our transfer tax system will end up. As of this writing, however, Democratic leaders are preparing an estate tax bill that would permanently extend the current transfer tax law. The legislation is expected on the House floor shortly. At the same time, H.R. 3905 (the "Estate Tax Relief Act of 2009") was recently introduced. Under H.R. 3905, in each of the 10 years from 2010 through 2019, the estate tax applicable exclusion amount will increase by $150,000 while the top estate tax rate will decrease by 1%. The GST tax will track these changes. By 2019, the estate and GST exemptions will be $5 million and the estate and GST tax rates will be 35%. After 2019, the $5 million exemption would be indexed for inflation. H.R. 3905 does not reunify the estate and gift tax applicable exclusion amounts or allow a surviving spouse to use the estate tax applicable exclusion amount of the first spouse to die (i.e., "portability"). On November 18, the House Ways and Means Committee agreed to move forward with a one-year patch, maintaining the 45% rate and $3.5 million exemption for 2010. There was no timing announced for the consideration of this measure, except that it is to happen before Congress leaves for the year (although that remains to be seen).

As soon as Congress acts, we will provide you with an immediate update.

Federal Estate, Gift and GST Tax Exemptions

The estate tax exemption applicable exclusion amount increased from $2 million to $3.5 million per person in 2009—the single biggest increase ever. As mentioned above, if the law does not change, in 2010 only there will be no estate tax.

The GST tax exemption, which tracks the increase in the estate tax applicable exclusion amount, also increased to $3.5 million in 2009. In 2010 there will also be no GST tax, absent a change to current law.

The amount of lifetime gifts that may be made free from gift tax using the gift tax applicable exclusion amount (above and beyond the Annual Gift Tax Exclusion) remains frozen at $1 million **even in 2010**, absent a change to current law.

As soon as Congress acts, we will provide you with an immediate update.

Federal Estate, GST and Gift Tax Rates

The top federal estate tax and GST tax rates remained at 45% for 2009. As stated above, current law calls for the estate tax and GST tax to be repealed in 2010, for that year only. In 2011 the estate tax and GST tax are to return, with a top rate for each of 55%.

While the estate tax and GST tax are scheduled to be repealed under current law, the gift tax will remain in place in 2010, with any gifts beyond the applicable exclusion amount and Annual Gift Tax Exclusion amounts subject to tax at the top individual income tax rate, which is currently 35%. Under current law, in 2011 the top gift tax rate will return to 55%, like the estate tax and GST tax rate.

Annual Gift Tax Exclusion

Each year individuals are entitled to make gifts of the Annual Gift Tax Exclusion Amount without incurring gift tax or using any of their lifetime applicable exclusion amount against estate and gift tax. The amount of the Annual Gift Tax Exclusion will remain at $13,000 per donee in 2010. Thus, a husband and wife together will be able to gift $26,000 to each donee.

The amount of the Annual Gift Tax Exclusion with respect to gifts made to non-citizen spouses will increase from $133,000 to $134,000 in 2010.

The Obama Administration's Revenue Proposals

Although we do not yet have answers on the estate and gift tax system, earlier this year the administration made some revenue proposals for 2010 that were released by the Treasury Department in its "Greenbook." The Greenbook contained several proposals that are of interest in the estate planning arena.

► **Require Consistency in Value for Transfer and Income Tax Purposes**

This proposal would require that the income tax basis of property received from a decedent or donor must be equal to the estate tax value or the donor's basis.

The executor or donor would be required to report the necessary information to both the recipient and to the Internal Revenue Service. This reporting requirement could apply to annual exclusion gifts and to estates for which no estate tax return is required.

The proposal would be effective as of the date of enactment.

► **Modify Rules on Valuation Discounts**

The Greenbook proposal would significantly limit many valuation discounts that are used to leverage transfers when planning with family limited partnerships and family limited liability companies.

The proposal would apply to lifetime transfers and transfers at death after the date of enactment.

► **Require Minimum 10-year Term for Grantor Retained Annuity Trusts (GRATs)**

The Greenbook proposes to require at least a 10-year term for all GRATs. This would eliminate the use of short-term rolling GRATs.

The proposal would apply to GRATs created after the date of enactment.

Because none of the revenue proposals have yet became law, particularly if you are considering planning with a family entity or short-term GRAT, it is advisable to proceed immediately.

Focus on Foreign Accounts: IRS Voluntary Disclosure Program and 2009 Foreign Bank Account Reports ("FBARs")

Much of the focus of the IRS in 2009 was on the reporting and taxation of foreign accounts. On March 26, 2009, the IRS announced a voluntary disclosure program until September 23, 2009 (which was extended until October 15, 2009), under which U.S. persons could come forward to disclose previously unreported foreign accounts and thus limit the possibility of criminal prosecution for prior non-reporting. This program went hand-in-hand with the negotiations between the Justice Department and UBS. At the same time, the IRS had been taking a much stricter and more far-reaching position on the need to file FBARs in a number of circumstances that had never before been focused on, such as where an individual was one of two or more discretionary beneficiaries of a trust with foreign accounts. The IRS ultimately granted an additional extension until October 15, 2009, for filing late FBARs and an even longer additional extension until June 30, 2010, for anyone with a beneficial interest in, or signature authority over, a commingled foreign fund (e.g., a foreign hedge fund or private equity fund account).

Tax Information Exchange Agreements ("TIEAs")

Concurrent with the IRS becoming much more active in efforts to encourage the disclosure of foreign accounts held by U.S. persons, 2009 saw additional countries demonstrating their willingness to cooperate with the United States on tax matters. TIEAs were entered into with both Gibraltar and Monaco in 2009 and at the end of 2008 with Liechtenstein. In addition, the United States and Luxembourg signed a protocol in 2009 that amended their current income tax treaty to allow for more tax information exchange. The United States and Switzerland also signed a protocol in 2009 updating their current income tax treaty to allow for greater tax information exchange.

Guidance for Expatriates Under Section 877A

On October 15, the IRS issued Notice 2009-85, which provides detailed information as to the mechanics of the application of the Section 877A "mark-to-market" rules to those who expatriate.

Foreign Account Tax Compliance Act

As a further tool in its arsenal to clamp down on tax evasion, on October 27, the House Ways and Means Committee unveiled its Foreign Account Tax Compliance Act. The legislation provides the IRS with new administrative tools to detect offshore tax abuses. The legislation requires broad disclosure of foreign accounts and certain payments received.

Conversion to a Roth IRA

A significant change announced this year is that, starting in 2010, the existing $100,000 income test for converting a traditional IRA to a Roth IRA will no longer apply. This change offers unique planning opportunities to subject retirement assets to taxation at current income tax rates, which may be lower than rates in the future. In addition, once the accounts are converted, future growth will not be subject to any income tax going forward as long as you meet the qualification of a tax-free distribution. In order to qualify, you must have had a Roth IRA for more than five years and be over the age of 59½, disabled or deceased. Roth IRAs do not have required distributions at age 70 (unlike traditional IRAs), so the money can accumulate for a longer period of time. If you choose not to withdraw the funds, you may transfer your Roth IRA at death without income tax liability to the recipient, which may provide a significant benefit. For conversions that occur in 2010, half of the taxable converted amount may be taxed in 2010 and the other half taxed in 2011.

Planning in an Uncertain Economy and against Estate and Gift Tax Uncertainty

The country experienced continued economic difficulties in 2009. While the stock market made a significant recovery, asset values have remained significantly depressed, as have interest rates. While these changes have been unsettling, they create significant estate planning opportunities. Low interest rates and low asset values create a unique environment in which to transfer assets with little or no gift or estate tax consequences, because a number of techniques turn on assets outperforming the IRS's assumed rates of return. For example, if the IRS assumes that an asset will earn a return of 3.2% and you have assets that are significantly depressed in value, you may transfer the "spread" between the 3.2% assumed rate of return and the actual future increase in value to your children or others with minimal or no gift or estate tax cost. There are a number of estate planning techniques that become significantly more valuable with depressed stock prices and low interest rates: charitable lead annuity trusts, private annuities, sales to "defective" grantor trusts and GRATs. Two of the most frequently used techniques are summarized below.

GRATs

A GRAT provides you with a fixed annual amount (the "annuity") from the trust for a term of years (as short as two years). (Note the Obama administration's proposal, mentioned above, that all GRATs be for a duration of at least 10 years.) The annuity you retain may be equal to 100% of the amount you use to fund the GRAT, plus the IRS-assumed rate of return applicable to GRATs (which for gifts made in December 2009 is 3.2%).

Because you will retain the full value of the GRAT assets, according to the IRS's assumptions, if you survive the annuity term, the value of the GRAT assets in excess of your retained annuity amount will then pass to whomever you have named with no gift or estate tax, either outright or in further trust.

Sales to "Defective" Grantor Trusts

Another option for transferring assets without any transfer tax is an installment sale to a "defective" grantor trust (a trust as to which you would be treated as the owner for income tax purposes and would pay the income taxes on the income generated by the assets therefrom but which is not included in your taxable estate upon your death).

You would sell assets likely to appreciate in value to the trust in exchange for a commercially reasonable downpayment and a promissory note for the balance. From an income tax perspective, no taxable gain would be recognized on the sale of the property to the trust because the trust is a defective grantor trust, which makes this essentially a sale to yourself. For the same reason, the interest payments on the note would not be taxable to you or deductible by the trust.

If the value of the assets grows at a greater pace than the prevailing Applicable Federal Rate (which for sales in December 2009 is as low as .71%), as with a GRAT, the appreciation will pass free of gift and estate tax. An additional benefit is that this type of transaction allows you to transfer assets to your grandchildren free from GST tax.

Family Limited Partnerships

Many clients have taken advantage of family limited partnerships (FLPs) (family limited liability companies, which are substantially similar, are also used, and are referred to herein also as FLPs). FLPs provide many advantages, such as protecting assets from creditors, consolidation of family-held entities with centralized management, and investment advantages as a result of investing a larger pool of assets. The value of assets held in an FLP may be substantially reduced by using lack of control and/or lack of marketability discounts. This reduction in value results in lower estate and gift tax liability.

Over the last decade, FLPs have come under heavy attack by the IRS, which has sought to disallow the discounts on FLP interests, and even to include the value of previously transferred interests. As a result, it has become crucial to understand and avoid the factual pitfalls illustrated in the many cases that are decided each year with regard to the valuation of FLP interests for estate tax purposes. In 2009, the IRS was more successful than not in challenging discounts. However, the few taxpayer wins were substantial and indicate that, with proper formation and administration, FLPs can continue to be successful planning vehicles, provided that the Obama administration's proposal to eliminate valuation discounts does not come to pass.

The IRS continued to succeed in eliminating FLP discounts where the taxpayer could not demonstrate a "significant, non-tax business reason" for creating the FLP. Examples of significant, non-tax business reasons that were upheld in this year's cases, however, include pooling assets to provide for central management (*Estate of Murphy v. U.S.*, Case No. 07-CV-1013 (W.D. Ark. October 2, 2009)), protecting against the dissipation of family assets by spendthrift children (*Estate of Murphy*), continuing a specific investment philosophy developed by the patriarch of a family (*Estate of Miller v. Commissioner* T.C. Memo 2009-119), and protection of assets from depletion in divorce (*Keller v. U.S.*, Civil Action No. V-02-62 (S.D. Tex. August 20, 2009)). It was also clear from this year's cases that documenting the significant, non-tax business reason for an FLP, *at the time of the creation of the FLP*, is key.

Another area in which the IRS continued to succeed this year in eliminating FLP discounts was related to the taxpayer's failure, *after* forming the FLP, to respect the corporate formalities of the FLP. For example, in a significant victory for the IRS (*Estate of Jorgensen v. Commissioner*, T.C. Memo 2009-66), the court cited the taxpayer's failure to maintain proper books and records or to hold formal meetings of the partners and keep minutes of such meetings as partial evidence of an FLP formed solely for tax (and not bona fide business) purposes. Thus, clients who have formed FLPs must continue to be careful to ensure that their FLPs are being properly administered and actively managed.

Finally, the IRS continues to succeed in eliminating FLP discounts where the taxpayer failed to maintain sufficient assets outside of the FLP in order to maintain his or her lifestyle without seeking additional funds from the FLP. In recent decisions, courts have held that the amount of assets left outside of the FLP also had to be sufficient to pay the client's estate taxes due on the assets he or she owned at the time of death (including those estate taxes attributable to the client's FLP interests). Last year, in a landmark decision (*Estate of Mirowski v. Commissioner*, T.C. Memo 2008-74), the Tax Court held that the payment of estate taxes should not have to be made from a source of funds outside of the FLP. Unfortunately, in 2009 two major cases (*Estate of Jorgensen v. Commissioner*, T.C. Memo 2009-66) held otherwise, making it unclear as to whether or not the payment of estate taxes from an FLP will result in unfavorable tax consequences. Thus, if possible, clients should try to retain sufficient assets outside of an FLP to cover both their living expenses and the eventual payment of estate taxes.

Year-End Checklist for 2009

Consider the following before 2009 is over:

Make year-end annual exclusion gifts of $13,000 ($26,000 for a married couple).

Make year-end IRA contributions.

Create 529 Plan accounts before year-end for children and grandchildren, and consider front-loading the accounts with five 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 2009 income tax return.

Planning Ideas for 2010

As mentioned above, there is considerable uncertainty as to what the estate and gift tax regime will be in 2010. Our best prediction is that the current 2009 estate and gift tax system will be extended for at least one year. However, it is possible that no legislation will be passed and that there will be no estate and GST tax for at least part of 2010, and thereafter the estate and GST taxes may go back to 2001 levels (i.e., only $1 million of applicable exclusion). Less likely, we think, but also possible, is that H.R. 3905 or some variation that increases the estate tax exclusion amount will be passed.

Planning Ideas for 2010 Regardless of Outcome of Estate and Gift Tax Regime

Below are a number of estate tax planning ideas that you might consider in 2010, in addition to those set forth above.

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 to the QPRT you can continue to reside in the residence until the QPRT ends, and even thereafter, if the property is leased back at fair market value from the new owners.

This planning is most effective when the value of the residence to be given is low and the IRS assumed rate of return is high. However, even though the IRS assumed rate of return is now low, housing prices have dropped across the country, which makes use of a QPRT beneficial. As a result, QPRT gifting is an important alternative to consider in 2010.

Alternatives to Section 1031 Exchanges: Gifts to Charitable Remainder Trusts

Many taxpayers owning certain kinds of appreciated real estate sell that property and “roll over” the gain, using Section 1031 of the IRC, 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.

An alternate approach to consider is a gift of the property to a charitable remainder trust, retaining for life a payment equal to up to 90% of the value of the gifted property. You would be allowed an income tax deduction equal to a portion of the gifted property. (In the case where 90% of the value is retained by you 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 you receive 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.

At your death, the charitable remainder trust can pay over to a family foundation, allowing your family 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 GRAT) 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 grantor trust for the children. That grantor trust has a low basis in the asset. If you purchase the asset back from the grantor trust for fair market value, no gain or loss is recognized. The trust would then hold cash equal to the value of the appreciated asset that was repurchased, leaving the same amount to escape estate tax. Alternatively, many GRAT instruments give the grantor the power to substitute the GRAT assets with other assets, which would allow the appreciated assets to be removed from the GRAT.

The advantage is that, on your death, the purchased or reacquired asset will be included in your 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.

Use of Intra-Family Loans

Because interest rates are so low, many techniques involving use of intra-family loans should be considered, including the following:

- The purchase of life insurance on the life of one family member by an irrevocable life insurance trust, with premium payments funded by loans from other family members.
- The creation of trusts by older generation members for the benefit of younger family members, to which the older generation members loan funds. The spread between the investment return earned by the trust and the interest owed will create a transfer tax-free gift.

Planning Idea to Protect against the Potential Loss of the $3.5 Million GST Tax Exemption

In order to avoid the loss of this year's $3.5 million of GST tax exemption if the law reverts to 2001 levels, you should consider the possibility of making lifetime gifts now. For married U.S. citizens, this can be achieved without paying gift tax. You would make a gift to your spouse of an amount equal to the unused portion of your current $3.5 million GST tax exemption before the end of this year in the form of a qualified terminable interest property (QTIP) trust. Your spouse will be the only beneficiary of this trust during his or her lifetime so that the trust will qualify for the unlimited marital gift deduction. The trust would be created before the end of 2009 but not funded until the very end of 2009 to allow time to see if Congress extends the $3.5 million GST tax exclusion into 2010. If the exclusion is not extended, the trust would be funded and treated as a QTIP. Your remaining GST exemption could then be allocated to the QTIP trust by making what is known as a "reverse QTIP election."

To allow for the most flexible planning, you could wait until October 15, 2010 (by going on extension), to file your gift tax return so that the choices as to what tax treatment to elect for the trust can be delayed as long as possible to allow Congress to act.

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

As a reminder, as of January 1, 2010, California's law regarding the enforcement of "no contest clauses" will change significantly with the enactment of Senate Bill No. 1264. The change in the law will be partially retroactive, applying to all instruments, whenever executed, that became irrevocable on or after January 1, 2001. Most notably, (a) declaratory relief ("safe harbor") actions to determine whether or not a particular action will violate an instrument's no contest clause are no longer expressly provided for, and (b) in contrast to the current general enforceability of no contest clauses, as of 2010 they will be enforced only in relation to three specific classes of actions: (1) direct contests brought without probable cause; (2) property ownership claims (but only if expressly provided in the no contest clause); and (3) creditors' claims (but again, only if expressly provided in the no contest clause).

As part of an attempt to narrow the budget gap, the California legislature enacted Assembly Bill No. 17 (amending Sections 18663, 19025, 19136 and 19136.1 of the California Revenue and Taxation Code, and amending Section 13020 of the California Unemployment Insurance Code) to allow the State to collect income taxes more rapidly. Beginning November 1, 2009, the withholding rates in the wage tables increased by 10%. In addition, the flat rate that applies to supplemental wages (i.e., overtime, commissions, retroactive salary increases) was increased from 6% to 6.6% and the flat rate that applies to stock options and bonuses was increased from 9.3% to 10.23%, also effective as of November 1. Estimated tax payments were also accelerated and are now due in different proportions—for 2009, the quarterly payments were 30% in April, 30% in June, 20% in September and 20% in January, and for 2010 and beyond, the percentages are 30% in April, 40% in June, 0% in September and 30% in January. For taxpayers paying under the annualization method, the 2009 cumulative portions of the total tax must be paid by the first three installment dates (normally 22.5%, 45% and 67.6%) and are increased to 27%, 54%, and 72%. For 2010, the cumulative portions are 27%, 63% and 63%.

Connecticut

Estate/Gift Taxes

For deaths occurring and gifts made on or after January 1, 2010, new Connecticut legislation (1) increases, from $2 million to $3.5 million, the threshold for the value of an estate or gift subject to the estate and gift tax; (2) reduces marginal tax rates on estates and gifts by 25%; and (3) eliminates the tax "cliff," which provided that if an estate was over the tax threshold by even a penny, the entire estate was subject to estate tax.

The legislation also increases the flat income tax rate for trusts and estates from 5% to 6.5% on or after January 1, 2009.

An executor will now have less time to file an estate tax return because the law will make the filing deadline six (rather than nine) months after the date of death, starting with deaths on or after July 1, 2009.

Personal Income Tax (Individuals)

The marginal Connecticut personal income tax rate increased from 5% to 6.5% beginning on or after January 1, 2009, for the following:

- Joint filers with taxable incomes over $1 million
- Heads of household with taxable incomes over $800,000
- Single filers and married individuals filing separately with taxable incomes over $500,000

Corporate Business Tax ("C" Corporations)

New legislations impose a 10% corporate tax surcharge for income years beginning in 2009, 2010 and 2011 for companies that have more than $100 million in annual gross revenues or file a unitary tax return for all of these years.

Illinois

Planning for Illinois Estate Taxes

As of January 1, 2009, Illinois froze its estate tax exemption at $2 million while the federal estate tax exemption was increased to $3.5 million. This $1.5 million gap between the federal and Illinois exemption amounts created a situation where many estate plans that were initially designed to generate no estate tax upon the death of the first spouse now could potentially have a tax due to the State of Illinois of approximately $210,000 if the death of the first spouse occurs before 2010.

In September 2009, a new Illinois law was enacted which provides a planning opportunity that alleviates the Illinois estate tax problem while allowing the full utilization of the $3.5 million federal estate tax exemption. Specifically, the new law authorizes the creation of an Illinois-only QTIP marital deduction election to be made upon the first spouse's death. In many cases, the estate planning documents of Illinois residents would need to be modified slightly in order to permit the use of the Illinois-only QTIP trust.

For decedents dying in 2010, based on current law (which we believe may be changed), there is no Illinois estate tax. Due to budgetary shortfalls, however, the Illinois legislature will likely take action to ensure that the Illinois estate tax is not repealed in 2010.

One possibility is that the Illinois estate tax will be re-linked to the federal estate tax (which also likely will be changed to prevent a repeal in 2010) and the issue as to differing exemption amounts will cease to exist, thus eliminating the need for the state-only QTIP legislation. Another possibility is that Illinois would establish a separate estate tax that is not linked to the federal estate tax, in which case the Illinois-only QTIP legislation will be a valuable planning technique to maximize the use of estate tax exemptions (both federal and Illinois) and to minimize the estate taxes paid at the death of the first spouse.

Marriage Constraints on Trust Beneficiaries

In a recent decision (*In re Estate of Feinberg*, Docket No. 106982, September 24, 2009), the Illinois Supreme Court upheld a restriction in an exercise of a power of appointment that limited the disposition of trust assets to only those descendants who had not married outside of the Jewish faith.

In this case, the husband created a trust at his death for the benefit of his wife and then, upon the wife's death, to their descendants who had not married outside of the Jewish faith. However, the wife had the right to redirect the trust assets under her will; and, in fact, under her will she directed that, at her death, trust assets be given outright to those descendants who, as of the date of her death, had not married outside of the Jewish faith (in effect, reconfirming the restriction already contained in the trust). Based upon certain technicalities, the court upheld this restriction in the wife's will because the determination as to whether the descendants were married within or without the Jewish faith was ascertainable at the date of the wife's death and a descendant's inheritance was not subject to a subsequent forfeiture if, after the wife's death, a descendant married outside of the Jewish faith.

The court did not rule on the validity of the restriction that had originally been included in the trust created by the husband for the wife's benefit. Due to the technical nature of the court's holding, it is uncertain (especially because this case is so recent) as to the extent and scope of the court's holding.

Virtual Representation—Family Settlement Agreement

The virtual representation law under the Illinois Trusts and Trustees Act has historically allowed certain members of a family who have an interest in a trust to enter into a family settlement agreement regarding trust construction and administration issues that has the full force and effect of a court order, but without the time and expense of the court process. Effective January 1, 2010, the virtual representation law will be expanded to allow greater utilization of the family settlement agreement procedure with respect to trusts with minor beneficiaries and unborn contingent beneficiaries (who currently are unable to utilize the virtual representation law to resolve disputes through agreement).

Under the new virtual representation law, parties having substantially identical interests and who do not have a conflict of interest may represent and legally bind minor beneficiaries and unborn beneficiaries with contingent interests, thus expanding the availability of dispute resolution through agreement.

Will Depository

Effective January 1, 2010, the Secretary of State is authorized to act as a depository for orphan wills and trust documents. The new law allows an attorney to deposit a will/trust document, for which the whereabouts of the testator/grantor is unknown, with the Illinois Secretary of State, who will store and index the document for public record. The attorney depositing the will/trust document must first make a diligent search to locate the testator/grantor and must certify that he/she was unable to locate the testator/grantor.

Convenience Accounts

Effective January 1, 2010, the newly enacted Banking Convenience Account for Depositors Act permits banks to offer a new type of account that will serve as a convenience account. The purpose of the new law is to reduce the number of estate claims relating to traditional joint accounts where one of the parties was on the account for administrative convenience, but he/she also inherited the entire account when the funding party died.

With a traditional joint account, the legal presumption (which may be contested in a court proceeding) is that, upon the death of one joint owner, the remaining joint owner owns the account outright, even if the account was set up using the deceased contributing joint owner's assets and the purpose of the account was merely (for example) to enable the non-contributing joint owner to pay bills on behalf of the contributing joint owner). In these situations, the account may have been a mere convenience account and was not intended to be a windfall to the surviving joint owner. The new law allows the creation of a new type of account that permits the convenience of a joint account without creating a right of survivorship in the non-contributing joint owner.

The Act does not require banks to offer such accounts and the law is repealed five years after its effective date.

Do-Not-Resuscitate (DNR) Directives

Effective January 1, 2010, a new law amends the Health Care Surrogate Act with respect to do-not-resuscitate orders. Under the amended Act, (1) only one witness is required (as opposed to two) for a DNR order; (2) the witness must attest that the person executing the DNR had an opportunity to read the do-not-resuscitate form and that such person either executed the do-not-resuscitate form or acknowledged their signature in the presence of the witness; and (3) the term "DNR" was changed to "do-not-resuscitate."

Uniform Prudent Management of Institutional Funds

Effective June 30, 2009, the Uniform Prudent Management of Institutional Funds Act (replacing the Uniform Management of Institutional Funds Act), provides rules for expending assets from "endowments" that have been donated to charitable institutions and for investing funds held by those institutions. Among other things, the Act (1) establishes a "prudent person" care standard for financial decision-making by charitable organizations and (2) replaces the "historic dollar value" standard for expenditures by providing that a charitable institution "may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines to be prudent for the uses, benefits, purposes and duration for which the endowment fund is established."

Notary Public—Cook County Residential Real Estate

Effective June 1, 2009, with certain important exceptions (e.g., funding one's own revocable trust), Illinois notaries public who notarize documents of conveyance of qualifying residential real estate in Cook County are required to create and provide for the recordkeeping of a "Notarial Record." The Notarial Record (a form of which is available on the Illinois Secretary of State's website) requires the inclusion of specific and detailed information regarding the transaction, as well as a fingerprint record. The law expires June 30, 2013.

Viatical Settlements Act of 2009

Effective July 1, 2010, the Illinois Viatical Settlements Act increases regulation over viatical settlement agreements (generally, an agreement for the sale of a life insurance policy by a policy owner before the policy matures) and stranger-owned life insurance (STOLI) agreements (generally, an "arrangement to initiate a life insurance policy for the benefit of a third party investor who, at the time of policy origination, has no insurable interest in the insured"). This new law, through disclosure obligations, supervision requirements and licensing/ethics standards, is intended to protect consumers, especially senior citizens, from unfair or deceptive practices.

New York

Simultaneous Death

New York has adopted the 1993 Simultaneous Death Act, which provides that unless the governing instrument otherwise directs, for the purposes of any disposition that takes effect upon the death of an individual, anyone who fails to survive such individual by 120 hours (i.e., five days) will be deemed to have predeceased such individual.

Powers of Attorney

New York State has made broad sweeping changes to its laws governing powers of attorney—instruments by which a principal can appoint an agent to conduct financial transactions on his or her behalf. These changes took effect on September 1, 2009, with respect to powers of attorney executed on or after that date. Powers of attorney executed before that date will remain valid, but will become subject to certain of the provisions in the new law expanding their use for benefits and health care purposes, providing enforcement procedures and establishing standards of care. Because of the unprecedented scope of this new legislation, it affects not only those who live in New York, but also anyone who executes a New York power of attorney in connection with the conduct of business in New York.

The law prescribes an entirely new statutory short form power of attorney, which presumptively survives the principal's incapacity and can be either currently effective or effective upon the occurrence of a future event. Unlike current law, it must be signed by both the principal and the agent, although not necessarily at the same time. Also unlike current law, the execution of a power of attorney will revoke all powers of attorney previously executed by the principal, unless he or she specifically provides otherwise. Powers of attorney may be used to make gifts, in accordance with a preexisting pattern of gifting, of up to $500 per year in the aggregate. All other gift-giving authority of any kind, including merely to change joint tenants or beneficiary designations, must be made in a separately executed "statutory major gifts rider." Powers of attorney may no longer be used to create, amend or revoke trusts. The statutory major gifts rider must be executed simultaneously with the execution of the short form power of attorney and must be both acknowledged in the same manner as a deed conveying real property and executed in the presence of two witnesses who are not potential gift recipients.

North Carolina

North Carolina repealed its gift tax in 2008, effective January 1, 2009.

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.

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