

Adapting Estate Planning
Strategies to Meet Client
Needs and a Changing Legal
and Political Landscape

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Introduction

The past year has been a year of significant change in the area of trusts and estates law, with a number of developments of particular significance. These include changes to the federal gift and estate tax exemption amount, the enactment of portability legislation permitting a deceased spouse's unused gift and estate tax exemption to be transferred to his or her surviving spouse, a lengthy period of historic low interest rates and asset values that greatly enhance many estate planning techniques, and the recognition of same-sex marriage in New York State, and a clarification of the tax implications thereof.

At the same time, perhaps the most important aspects of estate planning have not changed, and will never change. These include an individual's desire to pass on his or her estate in the unique, or not so unique, manner that he or she believes most appropriate (a right recognized throughout the common law of the United States as the "freedom of disposition"), an individual's concern for his or her children and a desire to protect them both during life and after death, and a wish for family harmony after the individual's death.

These are all broad themes that can each fill an entire book—this chapter can only serve to highlight them.

Four Key Trusts and Estates Law Developments

Perhaps the single most significant recent development in the area of trusts and estates law involves the federal gift and estate tax exemption, which has been increased to \$5 million through December 31, 2012. In addition, we are currently in an extremely low interest rate environment, which affects the applicable federal rate (or AFR), used in many estate planning transactions. These two facts, when combined, make this a particularly opportune time for individuals to engage in gift and estate tax planning.

The potential for portability of a deceased spouse's unused estate tax exemption to his or her surviving spouse is another significant development in the area of trusts and estates law although issues relating to the practical utility of portability are substantial.

Finally, and although applicable only to New York, where I practice, is the June 24, 2011, enactment of the Marriage Equality Act, recognizing the validity of same-sex marriages for all purposes under New York State law.

The Increase in the Gift and Estate Tax Exemption

Of these recent developments, the increase in the gift and estate tax exemption to \$5 million—up from \$1 million—is probably the development of greatest significance to most clients of substantial wealth. This is because the increased gift and estate tax exemption permits client to make the transfers that are often necessary to their gift and estate tax planning without thereby incurring a gift tax.

The fact that the current tax law, providing for the \$5 million gift and estate tax exemption, sunsets on December 31, 2012, at which point it reverts to a mere \$1 million, means that clients must take advantage of this increased exemption in the next thirteen months. Although some pundits have speculated that Congress might act on or before December 31, 2012 to make the \$5 million gift and estate tax exemption permanent, clients cannot plan based on guesses as to what this Congress, or a future Congress, might or might not do in connection with the tax law.

Low Interest Rates

The current trend of low interest rates is also of great significance in the area of trusts and estates law since low interest rates beneficially affect many gift and estate tax planning transactions.

The federal government issues applicable federal rates (AFRs), which are the interest rates required to be used in gift and estate tax planning, on a monthly basis. More specifically, three AFRs are issued each month: the short-term AFR, the mid-term AFR, and the long-term AFR. The short-term AFR is required to be used in connection with obligations with a duration of three years or less, the mid-term AFR is required to be used in connection with obligations with a duration of more than three years but not more than nine years, and the long-term AFR is required to be used in connection with obligations with a duration of more than nine years.

Of note, the applicable federal rates have never been as low as they are currently. For example, the short-term AFR for October 2011 is a mere sixteen basis points. Therefore, if a client were to loan \$1 million to his or her child in October 2011 with repayment due no later than three years from the date of the loan, the required interest component would be a mere \$1,600 per year! If the child can invest that \$1 million dollars and earn more than .16 percent per year during that three year period, the client will have effectively transferred wealth to his or her child without any gift tax consequence. If the loan were made to a grandchild or more remote descendant, or to an unrelated individual who is assigned to a generation deemed to be two or more generations younger than the client, the client might effectively transfer wealth without any gift tax consequence, or any generation-skipping transfer tax consequence (the generation-skipping transfer tax being an additional transfer tax generally imposed on taxable transfers to an individual two or more generations younger than the transferor).

Since the short-term AFR is currently a mere sixteen basis points, it would seem likely that the AFR can only go up from here, a consideration which is currently driving a lot of estate planning strategies—including the intra-family loan strategy just discussed.

The Legal Recognition of Same-Sex Marriages

Same-sex marriage, now permitted in New York State, is also driving a lot of estate planning for the obvious reason that individuals who were not previously able to marry, are now able to do so and need to conform their estate planning documents to the estate tax planning typical for married persons. Essentially, there are estate planning benefits for married couples that do not exist for unmarried couples—the most significant of which is the ability to get a marital deduction (although only for New York State tax purposes, and not under federal law because federal law does not yet recognize the validity of same-sex marriage). Consequently, many same-sex couples that decide to get married in New York State will also decide to revise their last wills and testaments, or revocable “living” trusts, in order to take advantage of the unlimited marital deduction for New York State estate tax purposes.

It should also be noted that the Obama administration had determined that it would no longer defend the federal Defense of Marriage Act (DOMA),

Public Law 104-199, which limits the definition of “marriage” for all purposes under federal law to a union between one man and one woman. Pub. L. No. 104-199, 110 Stat. 2419 (1996). At the same time, a number of cases are working their way up through the federal court system challenging the constitutionality of DOMA.

One of the cases challenging DOMA is *Windsor v. United States*, No. 1:2010-cv-08435 (S.D.N.Y. Nov. 9, 2010). In *Windsor*, the survivor of a New York same-sex couple that was married in Toronto, Canada (at a time prior to the enactment of New York’s Marriage Equality Act), is suing for a refund of the more than \$350,000 of federal estate tax that was paid upon the death of the deceased spouse. Notably, the federal estate tax would not have been payable had the couple been an opposite sex married couple because, in that case, the unlimited marital deduction would have applied for federal estate tax purposes.

The Obama administration’s decision to stop defending DOMA, combined with the *Windsor* case and the other cases currently challenging the constitutionality of DOMA, suggest that the last wills and testaments, or revocable living trusts, of same-sex married couples should be revised not only to take advantage of state law estate tax benefits in those states that recognize the validity of same-sex marriages, but also to anticipate the possibility (or perhaps even the likelihood), of the ultimate recognition of same-sex marriages for federal tax purposes.

Conclusion

Like most things in life, the area of trusts and estates law is in a state of constant flux. It is also a particularly complex area of law. It is for these reasons that sophisticated individuals will well understand the importance of utilizing a specialist in trusts and estates law to advise them in connection with their estate planning, as well as the importance of reviewing their estate plan with that specialist on a regular basis. While many attorneys will be able to prepare a simple will, or administer a small estate, wealthier individuals, whose estates will be subject to estate tax when they die, or others, whose family situations raise complex issues, will require the advice of a specialist in the area of trusts and estates law.

It is sometimes said that there is nothing more expensive than cheap legal advice; as this chapter suggests by reference to the complexity of the subject matter, nowhere does this statement hold greater truth than in the area of trusts and estate law.

Key Takeaways

- Advise clients to set up GRATs while interest rates and asset values are low, and before Congress acts to change the law in this area. Setting up a dynasty trust will also help to avoid estate and generation-skipping transfer taxation as long as the trust exists.
- Modifying or changing an irrevocable trust, while difficult, can actually be accomplished through several varied mechanisms.
- Individualize the client's estate plan by listening to the client's thoughts and concerns and responding to them appropriately in the client's plan.
- Encourage clients to discuss inheritance issues with their children to avoid issues after the client's death. Also, do not shy away from advising clients to consider utilizing an institutional trustee for the particular benefits that an institutional trustee brings to the table.

Related Resources

- *Seven Good Reasons Credit Shelter Trusts Remain Relevant*, JOURNAL OF ACCOUNTANCY (June 2011).
- *Best Planning Ideas*, AICPA PLANNER (Apr. 2011).
- *Using Trusts for Asset Protection*, AICPA Wealth Management Insider (Mar. 2011).
- *2010 Developments in Asset Protection Planning*, BNA Tax Management, ESTATES, GIFTS AND TRUSTS JOURNAL (Nov. 2010).
- *Issues and Opportunities Caused by the Repeal of the Estate Tax*, JOURNAL OF FINANCIAL PLANNING (Feb. 2010).
- *In the Twilight of the EGTRRA*, JOURNAL OF ACCOUNTANCY (Jan. 2010).
- *Irrevocable Trusts Under Attack: The Domestic Relations Angle*, ALI-ABA ESTATE PLANNING COURSE MATERIALS JOURNAL (Apr. 2009).

- *When You're Counseling Clients, Don't Forget About Asset Protection Strategies*, AICPA PLANNER (Dec. 2008).
- *Asset Protection: Consider the Implications*, TRUSTS & ESTATES (Nov. 2005).
- *Estate Tax Savings with Self-Settled Trusts*, PERSONAL FINANCIAL PLANNING MONTHLY (Aug. 2002).
- *When Your Child's Marriage Goes Bad, So Might Your Child's Trust: Spousal and Child Support Exceptions to Spendthrift Trust Protections*, ASSET PROTECTION JOURNAL (June 2002).
- *Self-Settled Asset Protection Trusts*, ESTATE TAX PLANNING ADVISOR (June 2002).
- *Planning With Spendthrift Trusts*, ESTATE TAX PLANNING ADVISOR (May 2002).

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