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In the Spotlight:

Gideon Rothschild is listed in the 2009 edition of *Chambers USA* as one of the nation's leaders in Wealth Management. **Gideon** is also listed among the "Top 40 Tax Advisors" by *CPA Magazine* and in Citywealth's Leaders List 2009 among leading international lawyers who are "generally acknowledged to possess a sterling reputation for expertise in their respective field."

The April 2009 issue of *ALI-ABA Estate Planning Course Materials Journal*, features articles by **Gideon Rothschild** on "Asset Protection Planning" and **Daniel S. Rubin** on "Irrevocable Trusts Under Attack: The Domestic Relations Angle."

Moses & Singer proudly announces that **Marguerite E. ("Lily") Royer** has become a Partner with the firm. Lily has over two decades of experience practicing matrimonial and family law, with an emphasis on matrimonial litigation. Lily will co-chair the firm's matrimonial practice with Arlene G. Dubin, a nationally-recognized authority on marital agreements.

Lori Anne Douglass was a featured expert on *Black Enterprise Business Report* in one of a series of TV interviews focusing on women and money. Lori's appearance is in conjunction with an interview on the same topic in the April issue of *Black Enterprise* magazine.

Legislative Update

Although the future of the federal estate tax remains unsettled, on March 26, 2009, Senator Baucus (D-Montana) introduced a bill to Congress that would make the federal estate and generation-skipping transfer taxes permanent and would carry forward indefinitely the \$3,500,000 exemption amount (as indexed for inflation after 2010). In addition, the new bill includes a portability provision that would make the unused exemption amount of the first spouse to die available to the surviving spouse. Finally, the new bill would reunify the gift tax and estate tax, creating a \$3,500,000 gift tax exemption.

Multiple bills have been introduced over the past year, some which seek to essentially freeze the estate tax rules that are currently in place and some of which seek to increase the federal estate tax exemption to \$5,000,000 and lower the maximum tax rate.

Absent the enactment of either the Baucus bill or some other estate tax reform legislation, the federal estate and generation-skipping transfer taxes will be repealed for all individuals dying

in 2010, and will revert back with a \$1,000,000 exemption in 2011.

Separately, in order to raise additional and sorely needed tax revenues, including a substantial portion of the extra \$58 billion necessary to pay for a broad reform of the US healthcare system, the Obama administration has proposed the elimination of two extremely popular estate planning techniques.

The techniques at risk are the grantor-retained annuity trust (GRAT) and the family limited partnership.

The administration's proposal to limit the estate tax planning utility of GRATs would require a ten-year minimum annuity term. This would serve to limit the usefulness of GRATs for older individuals because the grantor is required to outlive the annuity term in order for any property settled upon the GRAT to actually be removed from the grantor's taxable estate.

The administration's proposal to limit the estate tax savings available in connection with family limited partnerships would negate certain restrictions within the partnership agreement which serve to discount the value of the

partnership interest when compared against the value of the underlying assets allocable to that interest.

2009 Changes to Federal Estate and GST Tax Exemptions

On January 1, 2009, the federal estate tax exemption and the federal generation-skipping transfer (“GST”) tax exemption each increased from \$2,000,000 to \$3,500,000. This increase in the estate tax exemption, coupled with the decreasing value of assets as a result of current market conditions, may necessitate the revision of estate planning documents executed prior to 2009 and, at the very least, warrants a current review of those documents.

Typical Estate Plan Used by Married Couples

In order to ensure that no federal estate tax will be due until the death of the second spouse to die, while at the same time taking maximum advantage of the available federal estate tax exemption, the estate plan of a married couple will frequently be crafted using a formula clause providing that the maximum federal estate tax exemption amount will pass to a “Family Trust” (also known as a “Credit Shelter Trust”) upon the death of the first spouse to die and the balance of the estate will either be distributed outright to the surviving spouse or, alternatively, pass to a Marital Trust.

A Family Trust is typically held for the benefit of the surviving spouse and any descendants

and need not mandate the distribution of income or principal. In contrast, a Marital Trust is held for the exclusive benefit of the surviving spouse and requires that all income be distributed to the surviving spouse on an annual basis. The assets passing into the Family Trust will be exempt from federal estate tax upon the death of the first spouse to die and, if the Family Trust is drafted properly, those assets will also avoid the imposition of estate tax upon the death of the surviving spouse. Any assets held in the Marital Trust or owned directly by the surviving spouse in excess of his or her own exemption amount will be subject to estate tax upon the death of the surviving spouse.

Because the federal estate tax exemption has been increasing every two to three years since 2001, a formula clause is typically used instead of referencing a particular dollar amount in order to guarantee that the maximum possible amount will be sheltered from estate tax and to avoid the necessity of revising the Will every two to three years.

Impact of the Changing Exemption Amount

Where the Will divides the estate pursuant to a formula clause rather than by reference to a particular dollar amount, the recent increase in the exemption amount means that, as of January 1, 2009 the first \$3,500,000 (as opposed to \$2,000,000) of the estate will pass to the Family Trust, and a larger share of the estate will pass to the next generation estate tax free. However, the

“flip side” to this proposition is that a smaller share of the estate will pass for the exclusive benefit of the surviving spouse. This “issue” may also be exacerbated by the recent economic downturn.

As an example, the estate of a married individual with a formula clause in his or her Will dying in 2008 with a \$4,000,000 net worth would have had \$2,000,000 pass to the Family Trust and \$2,000,000 pass to the marital share. In contrast, if that same individual had died in 2009, \$3,500,000 of his or her estate would pass to the Family Trust and only \$500,000 would pass to the marital share. If that individual’s net worth had decreased by only 12.5% because of current economic conditions (i.e., \$4,000,000 to \$3,500,000), nothing would pass to the marital share.

Heightened Impact for Residents of Decoupled States

In addition, because certain states (including New York, Connecticut and New Jersey) have “decoupled” their state estate tax exemption from the federal estate tax exemption, if a formula clause in a Will is set to the federal exemption amount, a state estate tax will be due upon the death of the first spouse to die as a result of the increased federal exemption amount.

For example, since the 2009 federal estate tax exemption is \$3,500,000, \$3,500,000 would pass to the Family Trust if the Will contains a formula clause tied to the federal exemption amount. Accordingly, a New York decedent’s estate would owe New York State estate tax

on the \$2,500,000 excess of the federal exemption amount over New York State's \$1,000,000 exemption amount, resulting in a \$229,200 New York State estate tax bill.

For a married couple in a decoupled state, the widening of the gap between the federal and state estate tax exemption amounts presents a question as to whether the optimal estate planning result will be achieved by utilizing, at the cost of some state estate tax, the full federal exemption amount upon the death of the first spouse to die. One might ask why it would ever be advisable to pre-pay a tax that could be deferred - here until the death of the second spouse to die, by funding the Family Trust at the lower state exemption amount. The answer is that it is often advisable to pre-pay state estate tax in order to shelter additional assets (together with the likely appreciation thereon) from the imposition of federal and state estate tax upon the death of the surviving spouse. Many factors come into play in this decision and there is not a single "right" answer for all clients.

If you would like to review your estate planning concerning these issues, please contact one of our Trusts & Estates attorneys.

New Voluntary Disclosure Procedure for Offshore Accounts

The Internal Revenue Service announced, in a memo dated March 23, new guidelines to encourage US taxpayers to come clean on unreported offshore accounts without risk of significantly increased penalties.

Although there has been an informal voluntary compliance program in place for many years, many taxpayers have been reluctant to come forward for fear that the penalties can exceed the amounts in their offshore accounts. The new program sets forth maximum civil penalties and, if the taxpayer is eligible, may avoid criminal prosecution.

Taxpayers may avail themselves of the program provided they are not yet subjects of a criminal or civil investigation and that they cooperate fully with the Internal Revenue Service. All details regarding the source of the funds, how the taxpayer opened the account and whether there were other professionals involved in the establishment of the account, or any company or trust owning the account, will be required to be disclosed.

Voluntary disclosure requests will be resolved under the following framework:

1. The taxpayer must amend his or her income tax returns and file all applicable information returns including Form TDF 90-22.1 (Foreign Bank Account Return (FBAR)) and informational returns (i.e. Form 3520 or 5471) for the preceding six years (unless the account(s) were opened less than six years ago, in which case such returns must be filed for the number of years the account(s) existed).
2. The taxpayer must pay the additional tax and interest for the six years, plus an accuracy related penalty of 25% of the additional tax due.

3. The taxpayer must pay a 20% penalty on the highest balance in the offshore account during such six year period. This penalty may be reduced to 5% if the taxpayer did not open or create the foreign account (e.g., it was inherited), has not withdrawn from or added funds to the accounts during the six year period, and all US taxes were previously paid on the funds deposited in the account.

Taxpayers who wish to avail themselves of this opportunity must come forward prior to September 22, 2009.

Internal Revenue Service Commissioner Shulman said that "[F]or taxpayers who continue to hide their head in the sand, the situation will only become more dire", including potential criminal prosecution. If you have any unreported offshore accounts, please call us to discuss whether you are eligible for the voluntary compliance program.

The ABCs of DAPTs

Although many people have heard of "asset protection trusts" (APTs), few people know exactly what they are, or why they work so well to protect an individual's assets from potential future creditor claims. For example, a common misconception relating to APTs is that they involve handing over money to a shady banker on a Caribbean island and hoping that the IRS never finds out about it. In truth, however, APTs are not about saving taxes; in fact, they are almost always intentionally structured so that they are purely tax neutral.

Instead, APTs are used as a means to protect oneself from potential future creditor claims. For many years, APTs could only be established offshore. Due to the passage of legislation in eleven domestic jurisdictions in recent years, however, APTs can now be established onshore under the laws of Alaska, Delaware, Missouri, Nevada, New Hampshire, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah and Wyoming. And, significantly, the fact that an individual does not reside in one of those eleven states does not bar him or her from establishing an APT under the law of one of those eleven states.

But what exactly is an APT?

An APT is an irrevocable trust in which the creator (commonly known as the settlor), is a discretionary beneficiary, usually together with his or her family. And, despite the fact that the settlor might, within the discretion of the trustee, continue to benefit from the trust assets, his or her

creditors cannot enforce their claims against those assets.

There are several reasons why a domestic APT may be preferred over a foreign APT for certain individuals depending upon their specific circumstances. First of all, many people are uncomfortable with the idea of transferring their assets to the control of a foreign trustee. Second, although APTs, as noted, are almost always structured to be tax neutral, several informational tax returns are required to be filed in connection with a foreign trust which the settlor might find burdensome. Third, the establishment of a foreign APT can be more expensive than the establishment of a domestic APT. But, perhaps the most important reason why an individual might establish a domestic APT over a foreign APT is that a domestic APT is likely to work just as well in protecting certain types of assets, such as United States real estate or United States business interests

(although a foreign APT might be more protective of assets which can be invested overseas).

Perhaps the most important thing to remember about establishing an APT, however, is that it must be done proactively. In other words, once a known creditor is on the horizon, it is almost certainly too late to protect one's assets from that creditor through an APT. This is because fraudulent transfer laws, which exist in both foreign and domestic jurisdictions, prohibit transfers to a trust established in order to avoid known creditors.

Human nature being what it is, most individuals will not think about the need to establish an APT until after a creditor claim is on the horizon. That is the opposite of "planning" and serves no one well – after all, as the old saying goes it wasn't raining when Noah built the Ark.

Moses & Singer's **Trusts and Estates and Wealth Preservation** practice provides a full range of legal services for private clients. In addition to substantial experience in the traditional areas of will and trust drafting and estate administration, the firm's attorneys utilize the latest techniques to implement effective plans for business succession and tax minimization. The firm is also recognized as a leader in wealth preservation strategies to protect client assets from future creditors and potential litigation exposure.

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The firm's **Matrimonial and Family Law** practice provides private clients with representation in all aspects of marital and family law, ranging from consultations to negotiations and trials, as well as representation in pre-nuptial and post-nuptial agreements and divorce.

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