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Estate Taxes Flummox Planners Uncertain Future Fuels Trust Boom; Repeal Odds Wane

"We can help! Our team of experts will guarantee that you pass away in 2010 and avoid federal estate tax."

Gallows humor about estate taxes -- like this Internet spoof -- is in vogue these days because changes in the so-called death tax have left even savvy financial planners puzzled. And hope of a total repeal is now dim because of the shift in power to Democrats in Congress.

"By far the most important estate-planning issue faced by clients and planners alike is the future of the federal estate tax," said Jeffrey A. Baskies, a partner in the Fort Lauderdale, Fla., office of law firm Ruden McClosky.

The nearly century-old levy has meant heirs can see as much as half of their inheritance go to the Internal Revenue Service.

A 2001 law phased in a series of changes in the tax. In 2007 and 2008, a tax of up to 45% will be levied on estates over \$2 million. In 2009, the threshold will rise to \$3.5 million. In 2010, the tax will be lifted completely for a year, but reinstated in 2011 at up to 55% on estates over \$1 million.

What happens next is anyone's guess. Last month, Senate Finance Committee Chairman Max Baucus (D., Mont.) sponsored an amendment to a budget blueprint that would permanently extend the 2009 rates. But the budget resolution is nonbinding, and its future is up in the air.

The Fatal Accident Estate Planning Service, the fictitious group circulating a joke brochure on the Internet, sums it up like this: "If you don't die on time, your legatees could lose millions of dollars. We guarantee that you will turn into worm food in 2010 or we pay the estate tax. That's right. You don't have to worry about lingering comas or miraculous resuscitation attempts delaying your death and creating havoc for your executor."

Uncertainty has put a premium on keeping an estate plan up to date so changes in the law don't create unnecessary taxes or even change how assets are parceled out among beneficiaries, said Perry Ganz, an attorney at Tarlow Breed Hart & Rodgers P.C. in Boston.

Rich or poor, facing up to making an estate plan means facing one's mortality. Many advisers say that getting a client to focus on it is difficult under any circumstances.

Estate tax questions have provided yet another reason to balk, according to Len Adler, a wealth adviser in the Palm Beach, Fla., office of JPMorgan Private Bank.

Some held back in the hopes that an earlier Republican effort to repeal the tax would succeed. If the tax were to be repealed, why bother setting up trusts and other tools designed to pass assets on to heirs? Now, full repeal seems unlikely to many because of the recent Democratic victory in Congress.

"I think there's less paralysis today than there was a few years ago, but there's still enough uncertainty that it's getting in the way," said Mr. Adler.

A boom in trusts -- meant to reduce or avoid the gift tax -- has been one result of the fog. People once willing to whittle down their taxable estates by giving away money to friends and family now aren't so willing. The logic: Don't give away money if the estate tax is about to be repealed.

The federal gift tax exemption allows a person to give away a lifetime total of as much as \$1 million to friends, relatives or others without paying federal tax. One may also give away an unlimited number of annual gifts of \$12,000 to any number of individuals without eating into the \$1 million gift exclusion.

"This was a fairly common strategy for affluent folk, but dipping into the gift tax exemption just to get money out of the estate, when the estate tax might be repealed didn't make sense to some people," said Rande Spiegelman, vice president of financial planning at the Schwab Center for Investment Research.

GRATs, or grantor retained annuity trusts, have boomed as a way to give lucrative assets to family and friends without paying a hefty gift tax. A GRAT allows its owner to discount the taxable value of a gift, and is used to transfer appreciation on hedge funds, private equity, real estate and other assets without paying gift tax.

Beyond trusts and taxes is the living will. Many people he advises indicate they don't want life support if permanently unconscious or unlikely to recover, said Warren K. Racusin, a partner and co-chairman of the private client services group at McElroy, Deutsch, Mulvaney & Carpenter LLP in Morristown, N.J. "Should there be an exception if you're right at the end of 2009?" said Mr. Racusin. "And the flip side is that, if it's December 31, 2010, is it appropriate to emphasize that the client doesn't want extraordinary measures taken to remain alive into 2011?"