

The Taxpayer Relief Act of 1997 and Your Estate Plan: It's Time for the Two To Meet

Congress passed the Taxpayer Relief Act of 1997 about a year ago. Now it's time to make sure you've integrated the Act's changes into your estate plan. Here are just a few ideas on how to take advantage of these tax law changes.

TAX LAW CHANGE: Increase in the Amount You Can Transfer Tax-Free

The Act gradually increases the amount you can transfer tax-free during life or at death (now called the "applicable exclusion amount") from \$600,000 to \$1 million. (See the chart on page 4.)

Planning Strategies:

- ***Make additional lifetime gifts.*** If you already have made \$600,000 of lifetime gifts, you now have an opportunity to make additional tax-free gifts up to the current applicable exclusion amount and in excess of the \$10,000 annual exclusion.
- ***Review your estate plan.*** If it doesn't take advantage of the increased amount automatically, restructure your plan to do so. Also, even if your plan will automatically take advantage of the increased amount, make sure that it will still accomplish your goals. For example, say you have \$1 million of assets and a formula plan. Under prior law, on your death \$600,000 would go into a credit shelter trust for your kids and \$400,000 into a marital trust for your spouse. In 2006, however, the full \$1 million would go into a trust for the kids, and your spouse would end up with nothing, which likely isn't your desired result. Finally, if you used up your exemption long ago so your estate plan doesn't consider it, determine whether you should put formulas back into the plan.

TAX LAW CHANGE: Indexing for Inflation

Effective Jan. 1, 1999, the \$10,000 annual gift tax exclusion, the \$1 million generation-skipping transfer (GST) tax exemption and the \$750,000 special use valuation amount under Section 2032A of the Internal Revenue Code (IRC) will be indexed for inflation.

Planning Strategies:

- ***Review your estate plan.*** If your plan includes GST tax planning, determine whether it automatically takes advantage of the higher GST tax exemption, similar to credit shelter planning. If your document provides a formula, you should be OK. If, however, you specify a dollar amount, consider a change.
- ***Monitor your lifetime gifts.*** Make sure that you are taking advantage of the full amount of the annual exclusion as the amount increases.

TAX LAW CHANGE: Exclusion of Gain on Sales Of Personal Residences

Prior to the Act, two exclusions of gain on the sale of a principal residence were available: 1) an exclusion of all gain rolled over into the purchase of a replacement residence within two years before or after the sale, and 2) for individuals over age 55, a one-time exclusion of up to \$125,000 in gain. The Act repealed the rollover provision and changed the one-time exclusion. Now single taxpayers of any age can exclude gain of up to \$250,000 on the sale of their residences every two years, and married taxpayers can exclude gain of up to \$500,000.

Planning Strategies:

- ***Reconsider selling your residence before you die.*** Under prior law you may have been reluctant to sell your home before your death because of the potential capital gains tax. Now that the exclusion protects against the recognition of a greater gain, selling your home may make more estate planning sense.
- ***Reconsider establishing a qualified personal residence trust (QPRT).*** The new provision makes QPRTs more attractive. As a result of final QPRT regulations, a grantor no longer can repurchase his or her residence from a QPRT that is a grantor trust. The QPRT remainder beneficiaries, however, can purchase the residence from the QPRT. For income tax purposes the sale will be considered to have been by the grantor. The capital gain that does not exceed \$250,000 (or \$500,000 if applicable) should be excluded from the grantor's income, and the children will receive a full cost basis in the property.

TAX LAW CHANGE: Qualified Family-Owned Business Exclusion

Subject to certain requirements, the Act now provides that an estate can exclude an additional amount of up to \$675,000 in the value of interests in a qualified family-owned business. The excludable amount decreases dollar-for-dollar to \$300,000 by the year 2006 as the applicable exclusion amount increases. (See the chart, at right above.) Under the IRC, you must meet specific requirements to qualify for the exclusion. Note that, as of this writing, changes to the nature of this exclusion have been proposed.

Planning Strategies:

- ***Determine whether the exclusion will be beneficial.*** Rules are complex and there are many traps for the unwary. For example, certain events may trigger recapture of previously excluded amounts, resulting in tax liability for your heirs.
- ***Plan to qualify.*** If you believe that the exclusion is desirable, make sure that the transfer of your business will qualify and that your estate plan will take advantage of the exclusion.

TAX LAW CHANGE: Gift Tax Statute Of Limitations

Under the Act, a gift for which the statute of limitations has passed cannot be revalued for purposes of determining the applicable estate tax bracket and available exclusion amount. The statute of limitations will begin to run, however, only for adequately disclosed transfers. Under current law, therefore, the only acts for which there are no statutes of limitation are murder, tax fraud and inadequately disclosed gifts!

Planning Strategies:

- ***Adequately disclose all gifts.*** While there are no set rules of how to do this, you should, among other things, be specific about the gift made, when it was made, its value and how you determined the value.

TAX LAW CHANGE: Charitable Remainder Trust Qualification Rules

Under the Act, the actuarial value of the charity’s remainder interest in a trust must be at least 10% of the trust’s initial fair market value to qualify as charitable remainder trust (CRT). In addition, payments from a CRT may not in any one year exceed 50% of the CRT’s annual fair market value if it is a unitrust or 50% of its initial fair market value if it is an annuity trust.

Planning Strategies:

- ***Make sure that trusts continue to qualify as CRTs.*** Review all testamentary instruments creating CRTs or providing for further transfers to CRTs. The new rule also results in greater difficulty in qualifying CRTs for relatively young children. Thus, if your children are in their 20s, their 30s or perhaps even their 40s, it is likely that the remainder interest will be less than 10%, depending on the annuity amount.
- ***Make certain that CRTs also pass the 5% test.*** The change in the law neither repeals the 5% actuarial probability of exhaustion tests applicable to charitable remainder annuity trusts nor does it raise the probability tests from 5% to 10%. Thus, it is possible to pass the 5% probability of exhaustion test and flunk the 10% remainder interest test, or vice versa. Therefore, no CRT trust should be created without carefully analyzing all of the numbers.

Review Your Estate Plan Today

We’ve presented just a few ideas for maximizing the benefits of the Taxpayer Relief Act of 1997. Please call us to review your estate plan and make sure you don’t miss any opportunities to take advantage of the tax law changes.

Gift and Estate Tax Applicable Exclusion Amount

<u>Year</u>	<u>Amount Excluded</u>
1998	\$625,000
1999	\$650,000
2000-01	\$675,000
2002-03	\$700,000
2004	\$850,000
2005	\$950,000
2006	\$1 million