

ESTATE PLANNING *Legal Matters*

Kauffman & Forman

406 West Pennsylvania Avenue
Baltimore, MD 21204
(410) 823-5700

IN THIS ISSUE

Responding to a will challenge

Will Congress change estate taxes?

Trust couldn't fully deduct cost of investment advice

Settling a personal injury claim can affect estate planning

Cash donations to charity now require a receipt

IRS could restrict private annuity trusts

Responding to a will challenge

If you think there's a chance someone will challenge your will in court, there are a number of steps you can take.

Legal challenges to a will or a trust are unusual. Generally, a person making a challenge has to show the document was forged, or that you didn't have the mental capacity to understand what you were doing, or that you were unduly influenced by someone concerning your choices.

However, the odds of a court challenge increase greatly if someone is likely to be disappointed by an inheritance – or the lack of one. If you're planning to disinherit a family member, or treat some family members differently from others, you might want to consider how to prevent a disfavored person from attacking the will or trust in court.

One simple way is to discuss your choices with your heirs while you're alive, so they at least understand your reasoning. Of course, that might not do the trick – and you also might have good reasons for not wanting to discuss the matter now.

Another idea is to make a videotape that shows you signing your will and discussing its provisions. The video can go a long way toward disproving a claim that you lacked the mental capacity to understand your actions, or were unduly influenced. You can also get a doctor to provide a written assessment of your mental clarity.

A handful of states allow people to go to court while they are still alive and legally establish their will is valid.

No Contest

Some people include a "no contest" clause in their wills. This clause states a person who challenges a will in court will lose any inheritance under it. In other words, if an heir who is unhappy with his share tries to bring a court case, he will lose even the amount the will provided to him.

A number of famous people have

included such clauses in their wills, including Frank Sinatra and guitarist Jerry Garcia of the Grateful Dead.

State courts around the country have different reactions to "no contest" clauses. Some states uphold them as good policy, because they discourage squabbling among heirs. But other states reject them because they discourage legitimate challenges – such as where a malicious person bullied or exploited a vulnerable elderly person into giving them the bulk of their assets.

A few states will ignore a "no contest" clause, but only if the court challenge was reasonable and had a legitimate basis.

What's tricky about "no contest" clauses is they only make sense if you are giving at least a significant inheritance to the disfavored heir. If you disinherit someone completely or give them only a nominal inheritance, then a "no contest" clause won't work because the person has nothing to lose by going to court.

An interesting recent case in California involved a man with five children. He set up a trust that would give \$50,000 each to three of his daughters upon his death. The rest of the trust would be split by the other two children.

The man added an unusual "no contest" clause stating if any of the three daughters contested the arrangement, then all three of them would lose their \$50,000 payments.

A California appeals court upheld this arrangement on the basis the father could have feared the three sisters would collude as a group and have only one of them challenge the trust, thus risking only \$50,000 on the outcome rather than \$150,000. The court also said the clause was proper because it would encourage the sisters to pressure each other not to go to court.

» [back to the top](#)

Will Congress change estate taxes?

One question for the new Congress is whether to change the current estate tax schedule. As you can see from the accompanying chart, the current schedule is rather bizarre and can yield wildly different results depending on the year in which a person dies.

Generally, a person who dies in 2007 or 2008 can transfer \$2 million to heirs without being subject to estate tax (not including bequests to a spouse, which are tax free up to any amount).

In 2009, this figure rises to \$3.5 million. In 2010, the estate tax is repealed, but in 2011 not only does it come back, it does so with only a \$1 million exemption and a much higher tax rate. That means a fortune could literally ride on whether someone dies in the final days of 2010 or in the first few days of 2011.

The tax "basis" rules also change dramatically. Currently, if you inherit property, your new "basis" (for calculating the capital gains tax when you sell) is the property's value at the date of the first owner's death. Your basis is "stepped up" from the owner's original basis.

In 2010, all this changes, and you have to keep the first owner's basis (or the date-of-death value, whichever is less),

	Estate tax exclusion	Top estate tax rate	Top gift tax rate
2007-08	\$2 million	45%	45%
2009	\$3.5 million	45%	45%
2010	N/A	0%	35%
2011	\$1 million	55%	55%

except that you can step up the basis to \$1.3 million of the property (or more if the property is given to a spouse). But then in 2011, everything reverts to the old step-up rules.

It will be interesting to see if the new Congress decides it's not appropriate for such dramatically different results to occur for people who happen to die in one year rather than the next.

In any event, these wild swings in the tax laws mean it's more important than ever to have a solid estate plan in place – one that will maximize your ability to care for your loved ones regardless of the crazy legal landscape. We can help you put together a plan that will take all these issues into account and set your mind at ease.

» [back to the top](#)

Trust couldn't fully deduct cost of investment advice

A Connecticut trust had income of \$625,000, and spent \$22,000 on investment advisory fees. Can it deduct the \$22,000 on its income tax return?

Yes and no, says a federal appeals court. It can take a deduction – but only to the extent the advisory fees exceed 2 percent of its adjusted gross income.

Ordinarily, an individual who pays for investment advice can deduct the cost if

the fees (and other miscellaneous itemized deductions) exceed 2 percent of adjusted gross income. The court said the same rule should apply to a trust.

However, other federal appeals courts have ruled differently. The issue might not ultimately be resolved until it's taken up by Congress or the U.S. Supreme Court.

» [back to the top](#)

Settling a personal injury claim can affect estate planning

If you or someone you know is suing for personal injuries, it's important to remember the way the case is settled could affect estate planning.

Here's a tragic story illustrating this point. A couple in Michigan sued a doctor and a hospital for severe injuries to their daughter during childbirth. The daughter required special care for the rest of her life.

The doctor and the hospital settled the case. Under the settlement, the parents received a lump sum to compensate them for their own suffering and expenses. The daughter received two annuities that would

The IRS ruled the present value of the annuities was part of the girl's estate, and demanded \$500,000 in estate taxes.

The parents went to court, but the U.S. Tax Court decided in favor of the IRS.

However, the court suggested if the settlement had been set up differently, the estate tax problem might have been avoided. For example, if the annuities had been transferred at the girl's death to her parents or someone else, then the tax outcome may have been less onerous.

If you or someone you know has a personal injury claim, it's a good idea to

pay her \$5,000 per month for life (with the payments increasing 5 percent per year). The annuities were guaranteed to last for 30 years, and if the daughter died before then, the money would be paid to her estate.

The girl died when she was 12 years old.

consult on any estate planning issues. It might be possible to eliminate tax problems in the way the settlement is structured. In addition, a large personal injury settlement could in itself require a change in estate planning, since the additional money could alter the assumptions on which a previous plan was based.

» [back to the top](#)

Cash donations to charity now require a receipt

Starting this year, you can't take an income tax deduction for cash gifts to charity unless you have a written receipt from the charity or a bank record.

In the past, you didn't need a receipt to deduct small cash gifts to charity or most recurring gifts such as weekly church collections.

Also starting this year, you can't deduct gifts to charity of used clothing or household items unless they are in "good" condition. That's a problem because the new law doesn't specify



what "good" condition means. The IRS says it will try to clarify this soon.

Even if household items aren't in good condition, the law says you can still deduct them if you provide an appraisal showing the gift is worth more than \$500.

» [back to the top](#)

IRS could restrict private annuity trusts

The IRS is taking a hard look at private annuity trusts and could soon take away many of their tax benefits.

The IRS held a hearing on the trusts recently and is expected to issue a ruling later this year. The ruling won't affect older trusts, but it could mean that you don't want to create one in the future.

The trusts can be a good way to avoid taxes if you have highly appreciated investment assets, especially real estate. Ordinarily, if you sold such an asset, you'd have to pay a hefty capital gains tax bill.

With a private annuity trust, however, you sell the asset to a trust. For instance, parents might sell a property to a trust and name their children as beneficiaries. In return, the parents receive an annuity – a regular income stream, often for one spouse's lifetime or for the lifetime of the second spouse to die.

The advantage is that instead of having to pay the capital gains tax at the time of the sale, the tax is spread out over the period of the annuity payments. There may also be estate tax advantages to removing a valuable asset from your estate.

However, the IRS is now considering requiring the capital gains tax to be paid up front. For calculating the tax, the sale price would be the present value of the annuity payments.

If the IRS adopts this rule, it would not affect trusts set up before Oct. 18, 2006.

Of course, you can handle highly appreciated assets in other ways. For instance, if you're thinking of donating money to a charity you could get a big tax advantage from donating appreciated property instead. We'd be happy to discuss your options with you.

» [back to the top](#)

This newsletter is designed to keep you up-to-date with changes in the law. For help with these or any other legal issues, please call our firm today.

The information in this newsletter is intended solely for your information. It does not constitute legal advice, and it should not be relied on without a discussion of your specific situation with an attorney.

216.194.124.36/5.93