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Zero Estate Tax Planning: Many Roads to Heaven

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As calendar 2010 winds to a close, people are beginning to think about Jan. 1, 2011. On that date, the 2001 version of the federal estate tax returns. What does that mean? A 55 percent estate tax and a $1 million exclusion. That is a big change both from 2010's zero percent estate tax rate and unlimited exclusion and from 2009's 45 percent estate tax rate and $3.5 million exclusion. Many jokes have been made about the "luck" of the families of billionaires who died in 2010: Mary Cargill died in February. She was worth $1.6 billion and made her money the old-fashioned way (she married into wealth). Dan Duncan died in April. He was a Texas pipeline tycoon worth $9 billion and the 74th wealthiest person in the world. Walter Shorenstein died in June. He was San Francisco's largest landlord. And George Steinbrenner died in July. He owned the New York Yankees.

There are ways to attain a zero estate tax without dying before Jan. 1, 2011. The approach long favored by many was to have a will that reads "Being of sound mind, I spent it all." A client last week requested that when he is "placed in the box, the check to the mortician bounces." This client was worth $250 million before significant estate tax planning resulted in moving $100 million to irrevocable trusts for his children. His situation illustrates the problem with the "I spent it all" approach. How do you program your spending so that the last dollar disappears with your last breath?

One approach is through a "withdrawal" calculation. Assume you are 70 years old and worth $5 million. You have a 17-year life expectancy. Were you to earn 2 percent after tax and consume your assets in equal annual installments, you would spend $380,000 per year. At your death at the end of the 17th year you would have zero dollars left. What if you die prematurely? There will be money left, which is not your goal. What if you live longer? You will be out of money, which will put you on welfare, which is also not your goal.

A well-respected structure can help you achieve the right result: a part-gift, part-private annuity. You would give $500,000 of your $5 million to your children, and sell them the rest for an annuity. The payments would be the same $380,000 as in the withdrawal example. The advantage over the withdrawal format, however, is that if you die prematurely, nothing is included in your taxable estate (the check bounces); and if you live longer, the children must continue paying until you die (you need not go on welfare).

There is another approach to a zero estate tax that leaves you with all of your assets until you die, but one that few people pursue. You leave 100 percent of your assets to charity in your will or trust. You buy a life insurance policy for what you wish your children to receive. Have the policy owned by an irrevocable trust so that the proceeds will not be included in your taxable estate. Depending upon your age and the policy's face amount, payment of the premiums may not constitute "taxable"

SPECIAL REPORT

Top Women Lawyers

Our annual list of the Top Women lawyers in the state.

Thursday, May 12, 2011

Discipline
Receiver Sues Sedgwick For Malpractice
Sedgwick LLP has been hit with a $200 million malpractice suit over its work for accused fraudulent investment company Medical Capital Holdings Inc.

Health Care & Hospital Law
Former Biotech GC Acquitted
A U.S. judge acquitted former GlaxoSmithKline general counsel Lauren Stevens on Tuesday of all six charges against her in an investigation of the company's marketing practices for an anti-depressant.

Zoning, Planning and Use
The Curse of Chavez Ravine
Are the Dodgers' financial problems a case of delayed retribution for how Dodger Stadium came about? By **Gideon Kanner** of Loyola Law School

International
The Benefits of Bilateral Investment Treaties When Investing in China
Bilateral investment treaties operate as "free insurance" with its minimal costs and direct benefits. By **Allan Marson**, **Grant Hanessian**, and **Michiel Kloes** of Baker & McKenzie

Construction
What to Do With a Busted Project
Distressed real estate projects are getting a shot of much needed adrenaline from preferred equity. By **Anita F. Sabine** of O'Melveny & Myers LLP

Letter to the Editor
America Is a Fair Country
Leon Snaid responds to "Death of Osama bin Laden: Could There Have Been a Trial?"

Criminal
Panel Lawyers Could Be Curtailed
A committee of federal judges is considering whether to create a new "alternate" public defender's office in the Central District of California that would be independent of the existing institution.

Judge Bars Gang Injunction Enforcement
A federal judge has approved an unusual permanent injunction against the Orange County district attorney, barring him from enforcing a gang injunction won in state court against 48 people.

gifts. This is a terrific approach because it is so simple, and a terrific result, because it is so flexible. However, most people do not like life insurance. (That is a shame, since life insurance is an income tax shelter, and is easy to transfer free of gift and estate tax.)

Conscientious, consistent gifting over time can eliminate estate tax. Use of the annual gift tax exclusion (currently $13,000, but increased by a cost of living adjustment) plus the valuation discounts for giving an interest in a family entity can rapidly reduce the value of even a sizeable estate. Assume you have $10 million of investment real estate. You transfer it to a family limited partnership. A business appraiser opines that the discounts for lack of marketability and lack of control applicable to limited partnership interests are 40 percent. You and your spouse have three children, each of whom has two children. You set up an heirs trust. Using some well-known and respected case law, you can use 24 annual gift exclusions per year (three children plus three in-laws plus six grandchildren multiplied by two donors). That means that the two of you can transfer $312,000 of value per year. The 40 percent valuation discount means that that reflects $520,000 of underlying asset value per year. Assuming no changes in value or discounts, in less than 20 years you can transfer 100 percent of the value of the family partnership. The transfer can happen more rapidly by using your lifetime gift exclusion ($1,000,000 in 2009, which might also be the number in 2011); and sophisticated gifting strategies like private annuities and grantor retained annuity trusts.

There is an attractive approach that does not require any gifts during your lifetime: a "testamentary charitable lead annuity trust" (T-CLAT). This could be viewed as the lazy person's approach to attaining a zero estate tax result. However, people who have engaged in sophisticated lifetime planning but wish to backup that planning commonly use it. A T-CLAT is a trust that comes into existence upon your death. It is funded with the assets remaining in your estate. Those assets generate an annuity, which is paid to a charity which you (or your executor or trustee) select. At the end of a selected term of years, the annuity stops, the T-CLAT terminates and the assets are distributed to your heirs. The higher the annuity and the longer it is paid to charity, the higher the charitable deduction. Assume that upon your death the assets are distributed to a T-CLAT that pays charity an annuity equal to 7.782 percent of the assets' fair market value each year for 15 years. The charitable deduction would be 99.993 percent.

There are many ways to get to a zero estate tax result. Dying in 2010 is only one such approach, and hardly the most attractive one.

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Judicial Profile
Making Her Mark
A framed reproduction of Botticelli's Calumny of Apelles hangs in U.S. Magistrate Judge Jennifer L. Thurston's chambers. The colorful painting, rich in allegory, depicts Slander dragging Innocence - the victim of false accusations by Envy,

Intellectual Property
Nevada Newspaper Pursues Copyright Cases
Despite some recent unfavorable court rulings, a Nevada company appears to be doubling down on its bet that suing hundreds of defendants for infringing the copyright of a Las Vegas newspaper is a winning strategy.

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