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Estate Planning: The Watchword Is "Flexibility"

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As tax laws change and the federal deficit balloons, estate plans and planning documents need to be as flexible as possible. Here are three steps to take now.

The estate tax is scheduled to undergo many changes through January 1, 2011. Let's review the main points:

- Throughout 2007 and 2008, the amount an individual can leave free of federal estate taxes via her/his estate (called the "applicable exclusion amount") is $2 million.
- This amount is scheduled to rise to $3.5 million for calendar year 2009 and will have no limit during 2010 when, for that year only, the federal estate tax is to be repealed.
- Then, on January 1, 2011, the tax is to be reinstated and the exemption amount dropped to $1 million.

These are current law provisions, but with the new Democratic-controlled Congress, changes may soon be forthcoming. Because of the philosophical difference between the Democratic and Republican agendas, flexibility in this transitional period becomes all the more important.

Step 1: Decide How to Protect Your Spouse

Determining how much tax your estate may ultimately be subject to has become a guessing game: When will your death occur, and what will the estate tax rules be at that time? Two techniques for addressing this uncertainty are two-share planning and disclaimer by the survivor.

Two-share planning: For estates valued in excess of the "applicable exclusion amount," to avoid guessing wrong a standard planning technique is to divide the estate of the first spouse to die into two segments:

- The first, the *nonmarital* share, is designed to take maximum advantage of this increasing exclusion
- The second, the marital share, is designed to absorb any excess value and eliminate federal estate taxes at the time of the first spouse's death.

Flexibility is created and maintained by using formulaic language that details how the non-marital share will be funded, rather than by specifying a fixed dollar amount.

But many states now have a significantly lower exclusion amount than what federal law permits; and to the degree the nonmarital share is funded to the full extent of the federal exclusion, a state

estate tax liability may be created. Flexibility in the language of your documents funding the nonmarital share may be critical in avoiding this trap.

Disclaimer by the survivor: An alternative to two-share planning may be to create a plan using a disclaimer by the survivor. Typically, the disclaimer model leaves everything to the surviving spouse who, within nine months of the first spouse's death, must decide whether to exercise a disclaimer (a refusal to accept property from the deceased spouse). This enables the survivor to fully evaluate all facts and circumstances existing at the time of the first spouse's death, rather than being locked into a predetermined solution.

To avoid the traps created by an ineffective disclaimer, a surviving spouse *must* consult a qualified estate planning attorney before taking action related to settlement of a deceased spouse's estate.

> *Pull-out: The Pension Protection Act of 2006 included important elements that increase estate-planning flexibility. To learn more, read our booklet, "Understanding the Pension Protection Act of 2006," at www.tiaa-cref.org/thalo.*

Step 2: Know the Impact of Changes

The Pension Protection Act of 2006 included some important elements that increase estate-planning flexibility, such as:

- *If you're over age 70 ½, you can contribute up to $100,000 from an IRA directly to a charity. This provision is available only until the end of 2007. To qualify, the IRA custodian must pay the distribution to the charity you select.*

  The distribution serves to satisfy all or part of a required minimum distribution. From an estate planning perspective, you benefit because the size of your estate is reduced by the full value of the contribution to the charity, and you are also able to avoid the income taxes normally associated with an IRA distribution.

- *A nonspouse beneficiary can directly roll over inherited distributions from a qualified retirement plan to an IRA. Once in the IRA, benefits will be paid out according to the minimum distribution rules.*

  This means that a qualified retirement plan benefit may now be inherited by a child, for instance, allowing the child to have the funds paid directly to her/his inherited IRA and distributed over the child's actuarial life expectancy, as determined at the date of the participant's death. The tax-sheltered character of the IRA allows the assets to continue to grow tax deferred until such time as distributions are paid.

Step 3: Revisit Your Plan Regularly

Current law features a staggered instability until 2011, when a semblance of permanence is supposed to arrive. However, because this law involves a source of tax revenue, and because future government expenses cannot reliably be predicted, we should not assume the law will be implemented as written today. Also, given the present environment in which further changes to the law are being debated, estate planning cannot be a "do it once and forget about it" endeavor, but rather an evolutionary, you might say Darwinian, process: Those who are adaptable in their response to change will be the winners.

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