



SPRING 2010

Elder Law &
Estate Planning

Newsletter

Our Newsletter

Nay & Friedenbergs has designed this newsletter for people who have an interest in elder law and estate planning. We hope that it educates and becomes a resource for our friends, clients and partners in this area.

In each issue we will have an article that will stand alone as a self-contained primer on a specific subject. In this issue we discuss 2010 Taxes changes. It will be written for the non-specialist but hopefully will be of some benefit to many members of the community. We want you to feel free to copy it and distribute it as you see so fit.

Each issue will contain a second article on a subject of interest. This issue we focus on avoiding inheritance taxes.

Our newsletter can also be found on our website, www.naylaw.com in the event that you wish to print additional copies. Please send suggestions or thoughts to chad@naylaw.com.

Thank you,
Nay & Friedenbergs

How do People Avoid Inheritance Taxes?

When we die our executor or trustee must determine whether our estate is large enough to pay an inheritance tax. Under Oregon law the tax threshold is \$1 million. Under Washington Law the tax threshold is \$2 million. Under Federal law there is no tax in 2010, the threshold returns to \$1 million in 2011, but will probably be reset at approximately \$3.5 million once Congress addresses the issue. This article is intended to address, in plain terms, some of the strategies that are used by individuals to avoid or minimize state or federal inheritance taxes.

MARITAL DEDUCTION

The simplest strategy to avoid taxes is to leave assets to your spouse. The assets are excluded from taxation by what is called the "unlimited marital deduction." The same deduction applies whether all or some assets are left to the spouse.

CREDIT SHELTER TRUST

The most common strategy for avoiding taxes on the death of the second spouse is the credit shelter (or bypass) trust. The decedent leaves his assets in trust for the benefit of the surviving spouse rather than leaving them to her outright. The decedent gives her rights to income and to principle in order to maintain the same standard of

living. The surviving spouse can be the trustee. The credit shelter trust is not an asset of the surviving spouse so that on her death the assets are not in her estate. This means that the surviving spouse has a good deal of control over the decedent's assets but they are not technically in her estate on her death. Therefore, the size of her estate is reduced by what she would have otherwise received from her husband. This strategy can double the amount that passes tax free.

An example of credit shelter trust planning will highlight the advantage. If a couple each owns \$1 million dollars and the husband dies leaving his funds to his wife, she will own the full \$2 million dollars. On her later death that sum will be subject to the tax. If, instead, the husband leaves his \$1 million to a credit shelter trust for the benefit of his wife, giving her plenty of control, then the credit shelter trust will not be in her estate on her death. Her estate will only consist of \$1 million. The result will be no tax.

QTIP TRUST

A common problem with marital planning arises when the decedent leaves assets to a spouse in a less-than-outright manner. For example, a decedent leaving

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assets to a spouse that is not the mother of his children will often leave the assets in trust. The trust would restrict her ability to disinherit the decedent's children. These kinds of restrictions defeat the unlimited marital deduction unless the trust is a QTIP Trust. A QTIP Trust requires the spouse to receive all of the income, typically allows the spouse to receive some principle to maintain a certain standard of living but prevents her from determining the ultimate beneficiaries of the Trust. A QTIP Trust will avoid a tax on the death of the decedent although the remaining assets are taxable in the estate of the surviving spouse.

CHARITY

Any amount left to a charity is subject to an unlimited charitable deduction from inheritance taxes. This strategy can occur as part of lifetime giving and receive additional income tax deductions.

CHARITABLE REMAINDER TRUSTS

An individual can receive a partial charitable deduction through a charitable remainder trust. It is established as part of a lifetime giving plan or in a will or trust to take place at death. The trust allows the individual or a loved one to receive a stream of income for a period of time or a life. At the end of that period of time, the remainder of the assets is distributed to the charity. The individual, or decedent's estate, receives deductions for the actuarial calculations of the remainder interest.

CHARITABLE LEAD TRUST

The same strategy applies if you reverse a charitable remainder trust. That is, the trust gives a charity a stream of income for a period of time with the remainder going to a non-charitable beneficiary such as family.

The decedent gets a deduction for the value of the charitable portion of the interest but not for the remainder interest.

EXCLUSION GIFTS

An individual can make lifetime gifts of up to \$13,000 per person, per year without triggering a gift tax or filing. The \$13,000 is known as the "annual exclusion" and is periodically adjusted upward. These sums are not subject to a later inheritance tax.

GIFTS IN EXCESS OF THE EXCLUSION

Larger gifts can be used to transfer assets that are going to appreciate in value, such as stock or a business. If the gift is worth more than \$13,000, the amount over that sum is recorded by the IRS on a gift tax return and, on the death of the giver, the amount is included in his or her estate. There may be a tax on the death of the giver but it is on that dollar amount that was "frozen" at the time of the gift. The increase in value of that gifted asset is not part of the decedent's estate.

CRUMMEY TRUSTS

Gifts to minors can create problems due to the age of the recipient. These are typically resolved by the use of trusts. This solution, however, creates a tax problem: a gift to a trust, even if under \$13,000, is not excludable from gift tax considerations. This problem can be resolved though the use of a Crummey Trust. A Crummey Trust protects the gift for the minor and allows the giver to receive the full gift tax advantage that is otherwise lost though gifts to trusts. Similar results can be achieved though gifts to custodial accounts but custodial accounts provide fewer opportunities to postpone distribution.

LIFE INSURANCE TRUSTS

The gift of life insurance policies is attractive because policies have limited lifetime advantages to the owner/insured. The gift tax advantage is derived from the fact that the gift is of, essentially, cash value, which is usually much lower than the death benefit. However, it is the death benefit that is taken out of the taxable estate at death. For example, the gift of a policy worth \$50,000 in cash value, but with a death benefit of \$250,000 removes the larger sum from the owner/insured's estate. The gift is typically made to a life insurance trust to make sure the cash value of the policy is not squandered and that it is properly administered.

VALUATION DISCOUNTS

Certain assets owned within a family, such as real estate and businesses, can be structured to be worth less for tax purposes if divided into smaller units. The structuring, usually through a limited liability company (LLC) or limited partnership, creates conditions that are acceptable to the family but unacceptable to outsiders. The assets then suffer from lack of marketability and any potential buyer is faced with a lack of control. The assets so structured are worth 10% to 40% less than their actual fair market value and this is the value subject to the inheritance taxes.

SUMMARY

Larger estates can carefully plan to mitigate inheritance and other transfer taxes through these and other strategies. For an analysis of a particular situation consult with your legal and financial counsel.



New for 2010

Recent changes in the law may have a noticeable impact on you and your family. Here is a summary of the most important changes.

ESTATE TAX

Federal estate tax no longer exists in 2010. So, if Bill Gates dies in 2010, no matter how wealthy he is, his estate will not pay a penny in federal estate tax. However, if he dies in 2011, his estate could be subject to a lot of federal estate tax because the federal government will tax estates valued at \$1 million or more. Estates of decedents who passed away in 2009 are subject to federal estate tax if the total value was \$3.5 million or more.

The unusual structure of the federal estate tax system can be blamed on a political compromise. In 2001, federal tax law legislation called the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) provided for the gradual increase of the amount allowed to pass free of estate tax to eventually the "sunset" of the federal estate tax in 2010 and then the regression of the 2006 law in 2011. Experts had predicted that Congress would pass legislation in the meantime "correcting" this before December 31, 2009, but nothing happened. No changes have occurred as of this writing. It is unknown whether or not Congress will make any changes in 2010.

The State of Oregon, however, still imposes an inheritance tax on estates of \$1 million or more in 2010 and will continue to do so for the foreseeable future.

GIFT TAX

The gift tax exclusion of \$13,000 per gift per year remains in effect. This means that donors can give up to \$13,000 to as many individuals as they want in a year without having to file a gift tax return. Gifts over \$13,000 must be reported to the IRS on a gift tax return. Donors may give up to \$1 million free of gift tax over their lifetime. The State of Oregon does not have a gift tax.

CAPITAL GAINS TAX

When Congress eliminated federal estate tax in 2010, it also eliminated the "step up" in basis for capital gains tax on death. Investments such as stock and real estate are subject to capital gains taxes on the profit made between the original purchase price (basis) and the sales price when the investment is sold. Beneficiaries who inherited investments from a decedent got a "step up" in basis to the fair market value of the investment on the date of the decedent's death. This meant that the old purchase price (original basis) was forgotten. The beneficiaries would pay capital gains tax on the difference between the stepped up basis and the sales price. This generally resulted in little or no tax to pay as the stepped up basis was close to the sales price. In 2010, the step up in basis is eliminated and beneficiaries inherit the "carryover" basis (original basis). Heirs may have to do some sleuthing to determine the original basis as those records may be lost.

CHANGES TO OREGON'S ADVANCE DIRECTIVE FOR HEALTH CARE

Oregon's Advance Directive for Health Care allows an individual to appoint a health care representative to make health related decisions in the event of incapacity. Until recently, the law specifically excluded mental health decision making so the health care representative could not authorize mental health treatment on behalf of the principal.

Based on recommendations from Dr. Maureen Nash, a physician at the Geriatric Psychiatric Unit of Tuality Forest Grove Hospital, the Oregon legislature passed a change to the Advance Directive in the summer of 2009. Health care representatives are now empowered to make decisions for mental health treatment related to dementia-related behaviors. The authority is limited to a period of 18 days. The law is retroactive so that it applies to Advance Directive documents that have already been signed.

DO YOU HAVE US SAVINGS BONDS?

As of January 1, 2010, all Series "H" savings bonds will no longer pay interest to

owners. Series "E" savings bonds will stop earning interest beginning on July 1, 2010. This may be a good time to look at your savings bonds to determine whether they could be invested elsewhere. Remember that cashing savings bonds will result in taxable income that will have to be reported on your income tax return. Consult with your financial advisor and/or tax preparer if you have questions.



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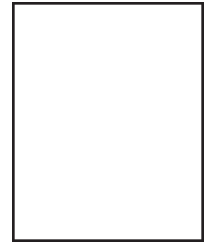
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CALENDAR OF EVENTS

SPRING 2010

MAY 11TH PRESENTATION

LEGACY GOOD SAMARITAN HOSPITAL

Amy Davidson will be presenting "Legal/Financial Planning for Mid-Life and Beyond" from 6pm to 8pm. Good Samaritan Hospital is located at 1015 NW 22nd Ave., Portland, OR 97210. To register, please contact Legacy at (503) 335-3500.

MAY 25TH PRESENTATION

NW PORTLAND ALZHEIMER'S SUPPORT GROUP

Garvin Reiter will be presenting "Medicaid and Long Term Care Planning" from 10am to 11:30am. The group meets at the Oregon Alzheimer's Chapter's main office. The office is located at 1650 NW Naito Parkway, Portland OR. For more information, please contact Kristrune at (503) 416-0206.

JUNE 8TH PRESENTATION

LEGACY EMANUEL HOSPITAL

Garvin Reiter will be presenting "Legal/Financial Planning for Mid-Life and Beyond" from 6pm to 8pm. Legacy Emanuel Hospital is located at 2801 N. Gantenbein Ave., Portland, OR 97227. To register, please contact Legacy at (503) 335-3500.

Please contact Chad at 503-245-0894 if you are interested in having one of our attorneys speak to a group you are involved with. (support groups, church groups, etc.)

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