

## Serving Clients in Uncertain Times

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Many people have strong views on the future of the federal estate tax, but no one knows what the future holds. Will current federal tax laws remain unchanged? Will the estate tax be permanently repealed? Will the estate tax exclusion amount, the former "unified credit", be permanently or temporarily increased?

When clients ask such questions, the best reply is to suggest that they be flexible in their estate planning with provisions that will be advantageous no matter what federal tax law changes may occur.

For 2007 and 2008, the federal estate tax affects only people who die with a taxable estate of more than \$2 million, the estate tax exclusion amount. Under existing law, the estate tax threshold will rise to \$3.5 million in 2009. For one year, 2010, the estate tax will be fully repealed, meaning in general the estate of an individual who dies in 2010 will not be subject to estate tax, regardless of their estate's size.

However, that repeal will remain in effect for only one year. In 2011, the federal estate tax will return with a threshold of \$1 million, which could potentially affect thousands of clients. In light of such uncertainties, a client's first instinct about estate planning may be to procrastinate or "wait and see" what happens. "Why address estate planning when we don't know the future of federal estate tax laws?" they may ask.

### PLANNING IN UNCERTAIN TIMES

But it is important that clients move forward. In fact, uncertainty makes it even more essential for clients to create, review, and update their estate plans routinely.

One reason for doing so is to ensure that client assets will be transferred according to their present desires after their death. Clients' plans should reflect what they would want to occur now should they die prematurely or experience a debilitating illness and be unable to consider their plan. Once plans are created, because estate planning isn't static, clients should periodically review their plans in case laws change, their family situation changes, or their goals for benefiting specific individuals and charities change.

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Estate plans serve purposes beyond tax planning. Clients have worked hard for their assets and want to be sure those assets are transferred according to their wishes after their death to their children, grandchildren, other family members, friends or charities. But if clients die before estate tax laws are resolved, and they used the "wait and see" approach, they may not have appropriate mechanisms in their plan to ensure that their assets pass to their favored beneficiaries.

Another reason to plan now rather than later is that beneficial planning opportunities may otherwise be missed. For example, if estate tax laws remain unchanged and the exclusion in 2011 returns to \$1 million, clients may wish they had acted to reduce the value of their taxable estates. One estate planning technique that could reduce the value of taxable estates is an irrevocable life insurance trust. However, to be fully protected in 2011 by this technique when the estate tax exclusion amount may revert to \$1 million, clients need to transfer existing life insurance policies to an irrevocable life insurance trust by December 31, 2007, because of the federal three-year "look-back" rule.

## **PLAN FOR THE UNKNOWN**

Flexible language in wills, trust agreements, durable powers of attorney, partnership agreements, and similar documents can be crucial. With estate tax laws in flux, flexible drafting can keep pathways open rather than shutting some off.

For example, many state statutes permit broad powers in durable powers of attorney. These broad powers may give the designated agent, or attorney-in-fact, power to create or amend a revocable trust, or the power to change beneficiary designations on jointly owned accounts, or power to modify an irrevocable trust agreement. Some planners have even suggested adding broad powers in "medical powers of attorney," or medical directives, for unusual circumstances that may arise in 2010 if the estate tax is eliminated for one year only.

Adding limited powers of appointment for a surviving spouse or other beneficiary in a revocable or irrevocable trust would provide the opportunity to adjust future beneficiaries from the level of children to grandchildren, or the reverse. Limited powers of appointment would also enable a surviving spouse or child to protect the share of a future generation descendant who is born with or develops special needs due to illness or injury.

Now that the amount of the applicable exclusion from estate taxes is and may remain higher than in the past, clients should consider the flexibility of sprinkling (or "spraying") the income from a credit shelter trust, rather than requiring that all the income be distributed to the surviving spouse. This decision should be made on a case-by-case basis. In some situations it may be advantageous to sprinkle income among children and grandchildren, who may be at low income tax brackets, rather than requiring all income to be distributed to the surviving spouse, who may be at a high income tax bracket. This flexibility is especially useful when the credit shelter trust is funded with substantial value.

The use of trust protectors is another drafting technique that may permit future flexibility. An independent trust protector may be granted powers to modify a trust agreement if changes in tax laws warrant modification, or even termination. A trust protector may provide limited powers of appointment in the protector's discretion to certain trust beneficiaries for broad or restricted purposes, such as adding charities as beneficiaries or creating a special needs sub-trust.

Despite federal estate tax law uncertainties, clients should create estate plans with broad, flexible provisions that incorporate some of the foregoing or similar techniques to produce a plan that will be beneficial no matter what the future of estate tax laws. Although we cannot plan with absolute certainty, we can develop estate plans that will be adaptable to changes ahead and be much more favorable than the "wait and see" approach.