



## The Advisor

An alert published by the Tax, Trusts & Estates Department of Cole, Schotz, Meisel, Forman & Leonard, P.A.

### The Time is Right for Sophisticated Estate Planning

While the bear market is negative by almost all accounts, it can create wonderful estate planning opportunities. In addition, since some Congressional proposals regarding the estate tax would limit taxpayers' ability to claim discounts, there is currently a sense of urgency with many discount techniques. We are advising clients to take advantage of this environment and proactively address estate planning issues right now.

The relatively low values applicable in valuing a taxpayer's principal residence, vacation home or commercial or rental property can be utilized with various estate planning techniques to remove real estate from the taxpayer's estate at a relatively low tax cost.

For example, a primary residence or vacation home can be gifted to a qualified personal residence interest trust ("QPRIT") which gives the owner the right to live in the home for a term of years, and after the term of years, the home will pass to children or a trust for their benefit. The value of the gift to children is based on numerous factors, the most important of which is the value of the property today. Further discounts are built in due to the fact that the children have to wait for the term of years to expire to receive the home and they may never receive the home if the taxpayer dies during the term. By utilizing this technique now, when property values are low, the value of the gift by the owner to children is suppressed and appreciation will be out of the owner's estate in a tax free manner.

Investment property can similarly be gifted to children in a leveraged fashion, in many cases taking into consideration fractional interest discounts or discounts for lack of control and marketability. In each of these planning techniques, the value of the real property transferred will be determined based on the current value of the real property. Future appreciation on the property, as well as income generated by the property, will be outside of the taxpayer's estate.

Real property does not present the only planning option in this bear market. Marketable securities can be utilized effectively in connection with planning. It is impossible to know whether an individual's marketable securities are at their lowest values or whether these investments will decline further in value. Nonetheless, clients can gift shares to children or trusts for their benefit at historically low values and the shares will grow outside of the taxpayer's estate.

Other techniques are attractive in this bear market due to currently low interest rates. For example, parents can make loans to children and take advantage of the very low interest rates in determining the repayment amount. Further, using grantor retained annuity trusts or selling assets to a grantor trust can be particularly effective to transfer assets to children due to low interest rates.

With all of these techniques, it is important to recognize that the donee's basis in the gifted assets will be based on the taxpayer's basis, so it is important, where possible, to utilize assets in the planning which have a high basis in the taxpayer's hands.

In sum, low valuations and low interest rates afforded by the current bear market make a number of estate planning techniques very attractive right now. Clients and their planners should not let this opportunity pass without taking appropriate action.

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## Increased Gift, Estate and GST Exemptions for 2009

**O**n January 1, 2009, the federal estate tax exemption and generation-skipping tax (“GST”) exemption increased from \$2 million to \$3.5 million. The lifetime gift tax exemption remained unchanged at \$1 million. The gift tax annual exclusion increased to \$13,000. Now, with proper planning under the new exemption amounts, a married couple with \$7 million or less of combined assets should not face exposure to federal estate taxes.

The increased exemptions raise several issues that professionals and clients should be aware of, including:

**Funding each spouse’s exemption amount.** An important estate planning concept is taking full advantage of each spouse’s full estate tax exemption amount. When the estate tax exemption was \$2 million per person, planners tried to make sure each spouse had \$2 million in his or her name. Now that amount has increased to \$3.5 million. For example, if Husband and Wife have a combined net worth of \$6 million, they or their advisors should be sure that the poorer spouse - who might have had \$2 million in his or her name before, have at least \$2.5 million in his or her name so that both spouses are under the \$3.5 million limit. Gifts from the wealthier spouse, division of jointly held properties, or inter vivos QTIP trusts can be used to accomplish this.

**Reviewing credit shelter trust provisions, especially in older documents.** If a Will or living trust funds the exemption amount to a specific dollar amount (eg, \$2 million), this provision should be reviewed and probably updated to reflect the higher exemption. If a Will or living trust uses a formula allocation, the formula should be reviewed to be sure it works properly.

The terms of the credit shelter trust should also be reviewed to be sure they are appropriate for the surviving spouse. For example, when the estate tax exemption was \$600,000 (not that many years ago), it was not uncommon for the credit shelter amount to pass outright or in trust for descendants only, because the surviving spouse would get the benefit of assets in excess of \$600,000. With a \$3.5 million exemption, that planning may no longer be appropriate.

**State level estate taxes.** In New Jersey and New York, the gap between the new federal exemption amount (\$3.5 million) and the state exemption amounts (\$675,000 in New Jersey, \$1 million in New York) is much more significant. The effect of this is that there are more tax dollars at stake in the decision regarding funding a credit shelter or exemption trust in the estate of the first spouse to die. Before 2009, funding a credit shelter trust to \$2 million (the old exemption amount) produced a state level estate tax of approximately \$100,000. Now, funding a credit shelter trust to \$3.5 million produces a state level estate tax of approximately \$229,200. There are a number of considerations regarding the optimal amount of assets to use to fund the credit shelter trust so as to produce the lowest overall tax result, including the size of the combined estates and whether the surviving spouse will be subject to state level estate taxes (or will move out-of-state). Planners will have to pay more attention to these considerations going forward.

**Larger GST exemption.** The larger GST exemption may offer tax-planning opportunities for clients with GST exempt irrevocable insurance trusts or other GST exempt trusts. Clients who have used all of their gift tax exemption or GST exemption with lifetime gifts should discuss this opportunity with their advisors.

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## New York Introduces New Power of Attorney Law

**E**ffective March 1, 2009, New York has significantly changed its power of Attorney statute. The major changes are as follows:

**New Statutory Short Form.** The statute prescribes a new Statutory Short Form Power of Attorney. A major change is that the agent must now sign the form (before a notary) in addition to the principal.

**Statutory Major Gifts Rider.** The gifting provision in the Statutory Short Form only permits gifts up to \$500. If a principal wants to authorize the agent to make larger gifts - i.e., virtually every case - the principal must execute a “Statutory Major Gifts Rider” or a non-statutory form POA.

The Statutory Major Gifts Rider (“SMGR”) has three substantive sections. Section (a) grants the agent limited authority to make annual exclusion gifts to the principal’s spouse, children, descendants and parents. Section (b) allows modifications where broader powers may be inserted. Section (c) allows the agent to make gifts to himself or herself.

The SMGR must be acknowledged and witnessed by two witnesses in the same manner as the execution of a Will. Generally, this requires two witnesses and a notary.

**Appointment of a Monitor.** In the new form there is an optional provision that the principal can appoint a “monitor” to request and receive records of transactions by the agent. The statute provides for a special proceeding that a monitor can bring to compel an agent to produce a record or receipts and disbursements and for other purposes. This provision should help reduce abuse of the power of attorney by the agent.

**Compensation.** The new form gives the principal the option to initial a box if he or she wants to provide reasonable compensation to the agent.

**Not retroactive.** The new law is not retroactive. Powers of Attorney property executed in accordance with the law in effect at the time of its execution remain valid.

If you have any questions about the new law, please contact us.

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### **Moving to Florida? Three Things You Should Know About Florida Homestead Law**

**F**lorida’s homestead law has three important components. First, homestead property is generally protected from claims of creditors. Second, homestead property enjoys a limit on annual increases of property tax assessments. Third, Florida law imposes certain restrictions on transferring homestead property.

To qualify as homestead property, the property must be the primary residence of a Florida resident. If the residence is located outside of a municipality, a homestead includes up to 160 acres of property. If the residence is located within a municipality, a homestead is limited to a one-half acre of property.

**Protection from Creditors.** Florida law broadly protects homestead property from creditors - so much so that Florida residents are generally not prevented from investing large sums of money in their homestead property as a way of shielding assets from creditors. In other words, a Florida resident can invest otherwise unprotected assets into his homestead property (by purchasing a large estate, substantially improving a residence or paying off a mortgage) and still protect those assets from creditors. This rule does not apply, however, if the contributed funds were obtained by fraudulent means.

Florida law also permits a resident to sell a homestead property and reinvest the proceeds in another homestead property within a reasonable period of time without losing homestead protection.

While Florida homestead protection is one of the broadest in the U.S., it does have limitations. Homestead property is not protected from tax liens, mortgages or contract obligations relating to repair or improvement services performed on the property.

**Cap on Assessed Value Increases.** Florida residents also enjoy a limit on any increase in the assessed value of a homestead property. Increases in assessed value for property tax purposes are capped at the lesser of (i) 3% of the prior year’s assessed value or (ii) the percentage change in CPI (which was 3.8% in 2008 and 2.8% in 2007). While the cap is less valuable in today’s economic climate where values are not appreciating, it has been very beneficial in appreciating markets.

**Restrictions on Transfer.** Florida homestead law limits an owner’s ability to transfer homestead property both during lifetime and at death. Generally, if a Florida resident is married, restrictions apply to lifetime transfers, as the spouse must consent to a sale, mortgage or gift of the property. If a Florida resident dies and is survived by a spouse or a minor child, restrictions apply to testamentary transfers.

If a Florida decedent is survived by a spouse and minor issue, the surviving spouse is entitled to a life estate in the homestead, with the issue taking a vested remainder interest; an outright transfer to the spouse is prohibited. It should be noted that if homestead property is jointly owned by spouses as tenants by the entirety, the homestead property passes at death to the surviving spouse, and the above restrictions do not otherwise apply. If a decedent has no spouse, but has minor issue, the decedent cannot devise the property to another person, even if the person is an adult child. If, on the other hand, a decedent has no spouse and adult children, he may transfer the property any way he desires. In short, homestead issues must be considered in any estate planning review.

Florida law allows a person to waive his homestead rights. For example, if a Florida resident is married for the second time and wants to devise the residence to his children or to any other beneficiary, the resident may enter into a marital agreement through which the second spouse waives her rights in the homestead property.

People who are relocating to Florida should have a general understanding of the benefits and burdens of Florida homestead law.

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### IRS Releases Guidance on Madoff-type Losses

**O**n March 17, 2009, the IRS released a Revenue Ruling and a Revenue Procedure which generally provide favorable tax treatment to Madoff investors who have suffered losses.

**Revenue Ruling 2009-9.** The Revenue Ruling has several important holdings: First, a Madoff-type loss is a deductible theft loss under Internal Revenue Code §165(c)(2) (transaction entered into for profit), and is not subject to a 10% of AGI limitation.

Second, the loss is deductible in the year of discovery, unless the investor has a claim with a “reasonable prospect of recovery.” The investor is permitted to take the theft loss deduction in 2008, and then makes an adjustment to taxable income in a later year (either an increase in income because the investor recovered a portion of the amount originally deducted or a larger deduction because the investor’s actual recovery was less than the original projected recovery).

Third, the deductible amount is equal to the investor’s basis, which includes all fictitious income that was included in income in prior years regardless of whether those years are “open” or “closed” for purposes of the statute of limitations.

Fourth, if the theft loss exceeds the investor’s 2008 income, he or she will have a net operating loss that can be carried back up to five years.

**Revenue Procedure 2009-20.** The Revenue Procedure provides a safe harbor for qualifying investors to deduct 75% of their loss (if pursuing any third party recovery) or 95% of their loss (if not pursuing third party recovery) after also subtracting any actual recovery and potential insurance/SIPC recovery, with a true-up in a later year when actual recovery is known (as described above). There are conditions to electing the safe harbor treatment and attachments that must be included with a return, so investors should work with their tax advisors to be sure this is properly handled.

The Revenue Procedure provides that investors in feeder funds that invested in Madoff are not “qualified investors,” though the feeder fund itself may be a “qualified investor.” Investors in this position will need to rely on how the feeder fund elects to treat the loss. This treatment would typically be reported on a form K-1 provided by the fund to the investor.

Investors who reside in New Jersey are still determining how to best treat the loss for New Jersey income tax purposes, since New Jersey does not permit a theft loss deduction. We are hopeful that New Jersey will provide guidance which permits Madoff investors tax relief for their previously taxed fictitious income. Investors may need to take action by April 15, 2009 to preserve potential New Jersey refund claims for 2005.

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### **New Jersey Tax Amnesty Program**

**L**ast week Governor Corzine signed a bill into law that requires the Director of the Division of Taxation to establish a tax amnesty period. The Division of Taxation recently announced that the Tax Amnesty Program begins on May 4, 2009 and ends on June 15, 2009. Under the Tax Amnesty Program, taxpayers who pay outstanding state tax liabilities for tax returns due on or after January 1, 2002 and prior to February 1, 2009, plus 1/2 of interest owed as of May 1, 2009, will not have to pay the other half of the interest owed, nor will they be liable for collection costs or civil or criminal penalties. Taxpayers under current criminal investigation for a state tax matter are ineligible to participate.

For taxpayers that received assessments currently under administrative review in Conference and Appeals or in a judicial appeals process, approval of the Director is required before acceptance into the Tax Amnesty Program. A five percent "amnesty eligible" penalty will be imposed after the amnesty period concludes on any additional taxes found due by a taxpayer that were not paid during the amnesty period for a tax period falling under the amnesty program.

Taxpayers participating in the Tax Amnesty Program are required to relinquish their appeal rights and rights to claim refunds of any amounts paid so a decision to participate must be carefully considered. The Director is expected to issue further guidance over the next few weeks. If you believe that you or a client may benefit from the Tax Amnesty Program, please contact us.

This alert is provided for general informational purposes only and may not be relied on as "legal advice." Legal advice can only be provided after specific consultation with one of our lawyers and engagement of the Firm to represent you, pursuant to a written engagement letter. If engaged, we will render such advice after a full review and analysis of your facts and circumstances. If you have further questions which you would like to discuss with us please contact one of the attorneys in our Tax, Trusts & Estates Department.

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