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# ESTATE PLANNING

***Babirak, Albert, Vangellow & Shaheen, P.C.***

## Announcements

Babirak, Albert, Vangellow and Shaheen is pleased to announce the addition of Todd Lochner, as Of Counsel to the firm. Mr. Lochner practices admiralty and maritime law, and he works in the firm's Annapolis office.

Todd Lochner graduated cum laude from the Tulane Law School, with a Maritime Law Certificate from the Tulane Maritime Law Center and a Certificate of Advanced

Study and Training in Arbitration. While attending Tulane, Mr. Lochner was a member of the Tulane Maritime Law Journal. His undergraduate studies were completed at The George Washington University. Mr. Lochner is a member of the bars of the State of Maryland, the United States District Court for the District of Maryland and the Fourth Circuit Court of Appeals.



## Estate Tax Consequences of Deathbed Gifts

The issue of whether an individual who is close to death can remove potentially taxable assets from his estate by making last minute gifts is a somewhat unsettled area of estate tax law. A recent decision by the U.S. Court of Appeals for the Second Circuit has shed further light on this issue. In the case of *Rosano v. United States*, 245 F.3d 212 (2d Cir. 2002), the court held that a decedent's estate could not exclude, for estate tax purposes, numerous gifts of personal checks made on the

decedent's deathbed when the checks were not cashed by the donees until after the decedent's death. The exclusion of deathbed gifts from the estate is known as the "relation-back" doctrine. Other federal courts have allowed relation back of deathbed gifts if made to a charitable beneficiary. See, e.g., *Estate of Belcher v. Commissioner*, 83 T.C. 227 (1984). The *Rosano* court, in fact declared that the relation-back doctrine could be used to exclude from a decedent's estate,

deathbed gifts of checks or other property to charitable donees, even if the gifts were not actually paid to, or cashed by, such donees until after the donor's death. If a dying individual, therefore, wishes to reduce the size of his taxable estate by making gifts to noncharitable donees, the donor should ensure the donees actually receive the gifted property before the donee's death. In the case of the gift of cash by check, the donee must cash the check before the donor's death.

## Life Status Appropriate Estate Plans

Different stages of life require different types of estate plans to preserve wealth and transfer it properly to the desired beneficiaries. Below is a brief summary of some of those stages and recommended estate planning documents.

### **Under Age 30 and Single**

Typically, a mere will is all that is required. Such will should leave directions for the distribution of possessions and assets in the event of an untimely death.

### **Living Together**

While some may not consider living together a “stage” of life, it is not uncommon today. Because unmarried couples are not granted the same rights by law as married couples, their estate plans need to be more aggressive. A will or revocable trust is imperative. A “no contest” clause in the will, moreover, may prevent challenges from family members.

A medical durable power of attorney should also be considered to enable the individual of choice to make medical decisions for the disabled.

If either member

of the couple, moreover, has children, guardianship of children provisions are especially important. For a non-biological partner to have a custody claim of a child, provisions in the biological mother’s or father’s will must clearly state the reasons therefore.

If both members of the couple have life insurance, separate irrevocable life insurance trusts can be created with the survivor as income beneficiary and children as principal beneficiaries.

A domestic partnership agreement, a legal contract which outlines the distribution of assets upon termination of the relationship prior to death is also a necessary document.

Ownership of certain assets, such as a house, car or checking account, under a joint tenancy with right of survivorship ensures that the surviving owner receive 100% of the asset.

### **Married with Young Children**

For most couples in this group, the primary concern is that their estate plan name testamentary guardians to take care of

their children in case both spouses should die. The guardian is responsible for the care and well-being of the children.

Consideration should be given as to whether a couple or individual will be the testamentary guardian. If the parents die without naming a guardian, a court will appoint an individual who may or may not be the individual the parents would have chosen.

The will may also govern how young children should receive their inheritance. This will likely involve a trust for the children’s benefit.

Life insurance should also be considered to replace loss of income. Term life insurance may provide adequate coverage at an economical price for young parents.

Both of the following trusts should also be considered:

**Revocable Trust:** Assets in a revocable trust avoid probate. A revocable trust, moreover, helps ensure continuity in the management of assets in the event of incapacitation or death. A revocable trust enables the grantor to do the legwork up front as opposed to leaving it to

## Life Status Appropriate Estate Plans continued

the grantor to do the legwork up front as opposed to leaving it to an executor after death.

**Credit Shelter Trust:** A credit shelter trust, moreover, ensures that both the husband and the wife utilize their exemption related to estate taxes. It can also provide income to the surviving spouse. Upon the surviving spouse's death, assets typically pass to children.

### **Baby Boomer Age 50**

The priority of baby boomers often begins shifting from wealth generation to wealth preservation. As such, estate taxes often become more of an issue. More sophisticated solutions should be considered to support the baby boomer during life and meet his or her transfer objectives at death.

A Qualified Terminable Interest Property Trust (QTIP Trust) helps avoid the transfer of assets to the surviving spouse's beneficiaries at his or her death, thereby avoiding a potential disinheritance of the first to die's children from a previous marriage.

A Grantor

Retained Trust is a trust which allows the grantor to retain an interest in the trust while freezing the value of the assets transferred to the trust.

A Charitable Remainder Trust is a flexible tax-savings tool which can help avoid immediate capital gains taxes on the sale of appreciated assets. In addition, such trusts generate an income tax deduction and reduce future estate tax liabilities.

An Irrevocable Life Insurance Trust removes proceeds from the taxable estate, thereby enabling heirs to receive the proceeds income and estate tax free.

### **The Golden Years**

Estate plans already put in place earlier in life should be revisited and re-evaluated at this time. Changes in net worth, tax laws and family situations could significantly impact the overall estate plan. Certain estate planning strategies should be considered. A state operated Section 529 savings plan could be established, thereby offering significant tax

advantages (see below). Tax free annual exclusion gifts of up to \$11,000 could be made to help reduce estate tax liabilities. Establishing a generation-skipping trust can help keep more assets in the family for a longer time. Forming a private family foundation for the management and distribution of charitable contributions may also be advisable. The use of family limited partnerships, limited liability companies and the re-titling of assets may help block any creditor claims against the estate. Lastly, a continuity of management plan should be in place in the event of illness or incapacity. Successor trustees and powers of attorney could play an important role in the continuous management of affairs and, therefore, should be chosen with this in mind.

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*“Different stages of life require different types of estate plans.”*

## The Estate Tax Treatment of College Savings Plans

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*“Section 529 plans are state sponsored college savings plans.”*

State sponsored college savings plans, known as Section 529 plans, are available today to help parents and others prepare for the impending cost of sending a child to college. Contribution limits vary depending on the type of plan. Some plans allow as much as \$256,000 to be contributed per beneficiary. Some states allow a state income tax deduction for contributions made to 529 plans. The assets in the 529 plan are treated as belonging to the contributor rather than the child for tax purposes. The fund, however, is not includible in the contributor's estate. According to federal tax laws, however, the contribution is considered a gift. As such, contributions may have federal gift tax consequences. Under the federal annual exclusion, this year a taxpayer may make a tax-free gift of up to \$11,000 (\$22,000 for married couples) per beneficiary, per year, and any amounts in excess of \$11,000 (\$22,000 for married couples) to the same donee in the same year are subject to the federal gift tax. However, a contributor to an educational savings trust, has the option of averaging the contribution over a five-year period. This means that if a contributor makes a contribution to a single

beneficiary in any one tax year that is greater than \$11,000 (or \$22,000 for a married couple), he may elect to average the amount of the gift over a five-year period. This allows a maximum contribution of up to \$55,000 (\$110,000 for married couples) without federal gift tax consequences. This election is made by checking the box on page 2 of Federal Gift Tax Return Form 709.

With regard to the issue of estate taxes, the amounts contributed to a 529 plan are not included in the contributor's gross estate for estate tax purposes. If, however, the contributor elected to average the contribution over the five-year averaging period for purposes of federal gift taxes, as discussed above, and the contributor were to die or cancel the account before the expiration of five years from the time the contribution was made, the contributor's gross estate will include the portion of the original contribution that is allocable to the years following the contributor's death.

Withdrawals from a 529 plan for non-educational purposes are subject to a 10 percent penalty. Effective January 1, 2002,

distributions from these plans will be tax free to the recipient and once yearly rollovers to another state's 529 plan are now permitted.

An Educational IRA, now called Coverdell Educational Savings Accounts, have a contribution limit of \$2,000 per contributor for year. The income eligibility for joint filing contributors was raised in 2002 to \$220,000. These funds may be used for elementary, secondary and parochial school tuition. An Educational IRA can be invested in any way the owner chooses, unlike a Section 529 plan, which is subject to investment restrictions.

New tax credits have also been created for college juniors and seniors, graduate students and others returning to school. These Hope and Learning credits, however, are phased out for single taxpayers earning between \$80,000 and \$100,000 per year. A new annual \$3,000 deduction, moreover, is available for individuals earning up to \$65,000 and couples up to \$130,000. Interest deductions for student loans are now available for single taxpayers earning up to \$65,000 and joint filers earning up to \$130,000.