ESTATE PLANNING

Fifth Edition

2007 UPDATE

On June 7, 2001 President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Tax Act"), which may be remembered not only for its sweeping changes to transfer taxes, qualified plans, and individual rate structures, but for its 2010 sunset provision. Legislation enacted after 2001 has changed income tax rates but has otherwise made minimal changes to the federal tax information included in this supplement. Anticipated changes to the federal estate tax rules designed to avoid the sunset provisions have not been enacted and at this date, change remains uncertain. Cost-of-living adjustments have been added where appropriate to dollar amounts discussed in these chapters.

This supplement also provides updates for changes in Washington law, including the Washington Principal and Income Act of 2004 and the new Washington Estate Tax which was enacted in May, 2005.

As with any overview, this supplement is designed to summarize key provisions of the new rules. Before taking any action, you should seek the advice of qualified advisors. Only they can provide complete and up-to-date counsel and recommendations to properly carry out your own planning arrangements.

Chapter 3 - Planning for Retirement

Sources of Retirement Income (Page 8)

Retirement Plans.

The various allowable contributions to both traditional and Roth IRAs are shown in the chart below. If you are at least age 50, you are allowed to make additional contributions to these accounts. You, or your spouse, must have earned income of at least the amount of the desired contribution. The

contributions may be deductible, depending on your income and participation in other plans.

Year	***IRA Contribution Limit***	***IRA Age 50 Additional Contribution***
2006 through 2007	$4,000.	$1,000.
2008 and later	$5,000. *	$1,000.

* After 2008, the contribution limit will reflect cost-of-living adjustments.

The annual contributions you may make to elective-deferral employer-sponsored retirement plans such as 401(k) plans, 403(b) annuities, SEPs, and SIMPLE-IRAs have also increased. Contributions to all of these plans are based on earned income and are subject to other plan provisions. If you are at least age 50, you are allowed to make additional contributions to these plans that are not subject to income limitations.

Year	***Contribution Limit***		***Age 50 Additional Contribution***	
	401(k), 403 (b), and SEP	***SIMPLE-IRA***	***401(k), 403(b), SEP***	***SIMPLE-IRA***
2005	$14,000.	$10,000. *	$4,000.	$2,000.
2006	$15,000. *	$10,000. *	$5,000. *	$2,500.
2007 and later	$15,500. *	$10,500. *	$5,000. *	$2,500.*

* After 2006 (2005 for the SIMPLE-IRA contribution) the limits and additional contribution amounts reflect cost-of-living adjustments.

Chapter 4 - Social Security

As a reminder, the dollar limitations in social security benefits, the wage base, and excess earnings are adjusted annually for increases in the cost of living. For example, the maximum annual compensation covered is $94,500 for 2006 and $97,500 for 2007 compared to $68,400 for 1998, as discussed on page 13.

Working After Retirement Can Affect Your Social Security Benefits (Page 14)

The Senior Citizens' Freedom to Work Act of 2000 made changes to the rules regarding the loss of benefits by social security recipients who work and receive "earned income." Individuals who work and are "full retirement age" (age 65 and 8 months in 2006) or older for all of a year may keep all of their benefits. Individuals who are under "full retirement age" (age 65 and 8 months in 2006) lose $1 of social security benefits for each $2 dollars of earnings over $12,480 in 2006. Those who reach age 65 and 8 months in 2006 lose benefits in 2006 at the rate of $1 for each $3 of pre-retirement earnings before the date of attaining age 65 and 8 months over $33,240 for 2006. Full retirement age in 2007 is age 65 and 10 months. The "under full retirement age" earnings limitation for 2007 is $12,960 and the limitation for individuals reaching age 65 and 10 months during 2007 is $34,440.

Chapter 6 - Legal Planning for Incapacity

Special considerations (Page 27)

In 2000 the Washington Legislature authorized streamlined court proceedings to obtain court supervision of certain attorney-in-fact actions, for example, to obtain a court order to require a financial institution to recognize the durable power of attorney or to approve an accounting by the attorney-in-fact. These court proceedings can be requested by the attorney-in-fact or certain close family member. If the principal does not intend a family member to be able to start such a court proceeding, the principal must make a specific statement in the durable power of attorney.

Chapter 7 - Personal and Financial Aspects of Disability: *Qualifying for Public Assistance; Long-Term Care Insurance*

The following changes are effective as of 2006:

- The mailing address for Medicaid applications is:

  Holgate Home and Community Services Office
  P.O. Box 24847
  Seattle, WA 98124-0847

- To qualify for COPES benefits, the applicant's gross monthly income cannot exceed $1,737.
- For a married couple to qualify for COPES or nursing home Medicaid benefits, their non-exempt resources cannot exceed $89,000. This includes $2,000 for the nursing home spouse and $87,000 for the spouse at home.
- If the gross income of the spouse at home is less than $1,452, he or she can keep income of the nursing home spouse to bring his or her total income up to $1,452 per month.
- The divisor to calculate the transfer penalty for Medicaid eligibility has been increased from 4,130 to 4,689.

The above amounts change periodically. Consult your advisor for current information on the Medicaid eligibility rules.

Chapter 13 - Do You Have a Will Appropriate for Current Circumstances?

What Your Will Covers (Page 64)

Your probate estate would not include, for example, (i) bank or brokerage accounts held in joint tenancy *with* rights of survivorship or (ii) property, such as insurance benefits or retirement plan benefits, that is paid directly to a beneficiary you have designated. Under Washington law, you can specifically provide in your Will for designation of a new beneficiary for a bank or brokerage "payable on death" or "transfer on death" account, or can designate a different post-death owner of a "JWROS" bank or brokerage account.

What a Personal Representative Does (Page 64)

The personal representative also has the duty to settle any claims or debts against you or your estate and to pay any death taxes owing on account of your death from your probate estate or, in some cases, your non-probate assets.

Chapter 16 - Tax on Lifetime Gifts

Gift Tax Exclusions (Page 79)

For years beginning after 1998, the annual exclusion gift amount will be increased in $1,000 increments for inflation that occurs after 1997. The annual exclusion amount increased to $11,000 for 2003 through 2005 and is $12,000 for 2006 and 2007.

The Applicable Credit Amount (Page 80)

The 2001 Tax Act increased to $1,000,000 the lifetime gift exemption (formerly referred to as the applicable exclusion amount), effective in 2002. In addition, the maximum gift tax rate will decrease from a maximum rate of 55% in 2001 to 50% in 2002, decreasing by one percentage point per year thereafter until the rate reaches 45% in 2007. In 2010, the maximum rate is adjusted again to the maximum individual income tax rate, which will be 35%. The gift tax is not repealed by the 2001 Tax Act.

Disadvantages of Gifts (Page 81)

The 2001 Tax Act increase the exemption for estate tax during the period from 2004 through 2009 to amounts that exceed the lifetime gift tax exemption. The Act repeals the estate tax for the year 2010. The difference in the gift and estate tax exemption amounts and the repeal of the estate tax highlight one disadvantage of making taxable gifts - which is that the gift tax must be paid shortly after the gift while the estate tax is deferred until you die. Combining the deferral period for paying the tax with an increasing estate tax exclusion, lower tax rates, and a possibility of complete repeal means that if you wait until death to transfer assets, there may be no transfer tax at all.

Chapter 17 - A Cost of Dying: Estate Taxes

The 2001 Tax Act significantly decreased the estate tax for years 2002 through 2009 and repeals it completely in 2010. However, the Act has no effect beyond the year 2010, unless Congress acts to extend it. The decreases and repeal, plus the possibility that both are temporary, complicate estate planning because of the uncertainty as to what the estate tax rules will be when you die. It is important to consult your tax advisor before making changes to your existing estate plan. You may want to review your estate plan with your advisor to determine whether your

existing plan provides enough flexibility to maximize the advantages of the changes in the law while still providing the desired benefits to your beneficiaries.

Overview of Federal Estate and Gift Tax (Page 85)

The Taxpayer Relief Act of 1997 increased the estate and gift tax applicable exclusion amount beginning in 1998. Beginning in 2002, the 2001 Tax Act decreased the top marginal transfer tax rate, *capped* the gift tax applicable exclusion at $1,000,000, and increased the estate tax applicable exclusion amount. The table below summarizes the changes:

In the case of gifts made, and estates of persons dying, during:	*Applicable Exclusion Amount*		*Applicable Credit Amount*		*Maximum Transfer Tax Rate*
	Gift Tax	*Estate Tax*	*Gift Tax*	*Estate Tax*	
1998	$625,000.	$625,000.	$202,050.	$202,050.	55%
1999	$650,000.	$650,000.	$211,300.	$211,300.	55%
2000 and 2001	$675,000.	$675,000.	$220,550.	$220,550.	55%
2002	$1,000,000.	$1,000,000.	$345,800.	$345,800.	50%
2003	$1,000,000.	$1,000,000.	$345,800.	$345,800.	49%
2004	$1,000,000.	$1,500,000.	$345,800.	$555,800.	48%
2005	$1,000,000.	$1,500,000.	$345,800.	$555,800.	47%
2006	$1,000,000.	$2,000,000.	$345,800.	$780,800.	46%
2007 and 2008	$1,000,000.	$2,000,000.	$345,800.	$780,800.	45%
2009	$1,000,000.	$3,500,000.	$345,800.	$1,455,800.	45%
2010	$1,000,000.	N/A	$345,800.	N/A	35%
2011 *	$1,000,000.	$1,000,000.	$345,800.	$345,800.	55%

* Assuming that the provisions of the 2001 Tax Act are not extended after 2010.

Using the Marital Deduction (Without Overusing It) (Page 88)

The potential family estate tax savings from using both spouses' estate tax applicable exclusion amounts have been greatly enhanced by the 2001 Tax Act. However, use of the increased exclusion or the marital deduction in the estate of the first spouse to die must be considered in light of the non-tax considerations discussed in this chapter in Estate Planning - Fifth Edition.

Washington State Estate Tax (Page 88)

The 2001 Tax Act phased-out the federal credit for state estate taxes between 2002 and 2004, reducing the credit by 25% in each of the four years beginning in 2002. After 2004, the credit is not available.

This change was interpreted by the Washington State Supreme Court as effectively repealing the Washington Estate Tax beginning in 2005. (*Estate of Wylie Hemphill, et al v. Department of Revenue*) Subsequent to the decision in Hemphill, the Washington legislature passed a new Washington estate tax. Governor Gregoire signed the new tax into law on May 17, 2005, effective for deaths occurring on or after May 16, 2005.

The Washington estate tax is independent of the federal estate tax except with regard to definitions of some terms. If, as the federal rules currently provide, the federal tax is repealed in 2010 and resurrected in 2011, the Washington tax remains unaffected.

The Washington tax applies to all real and tangible personal property located in Washington as well as to intangible assets owned by Washington residents. Washington has no gift tax, and lifetime gifts are not considered in calculating the Washington Estate Tax. Lifetime gifts minimize the Washington estate tax.

The tax is computed by subtracting the exemption amount ($1,500,000 for 2005 and $2,000,000 for 2006) from the federal taxable estate, as adjusted. The Washington adjustments include a deduction for farmland and, in some circumstances, a Washington-only marital trust deduction.

Estate Planning Examples (Pages 89 through 91)

With the 2001 Tax Act's increasing estate tax applicable exclusion, these examples are less meaningful because they address the specific tax savings from utilizing the estate tax exemptions of both spouses rather than maximizing the tax-free transfer of assets to the surviving spouse. As the estate tax applicable exclusion increases, there is a greater likelihood in many families that the surviving spouse's exemption will be sufficient to eliminate the estate tax.

Chapter 18 - Generation-Skipping Transfer Taxes

The 2001 Tax Act increased the generation-skipping transfer tax exemption to $1,500,000 beginning in 2004. Until 2004, the exemption was $1,000,000 adjusted for inflation. (In 2001, the exemption was $1,060,000.) From 2004 through 2009, the exemption is the same amount as the estate tax

exemption, and the tax rate is the maximum transfer tax rate. For each year's exemption and tax rate, please see the table included in the discussion of changes to the estate tax (Chapter 17). In 2010, the generation-skipping transfer tax is repealed subject to resurrection in its pre-2002 form if the 2001 Tax Act provisions are not extended.

Chapter 19 - How Complicated Does Your Will (or Trust Agreement) Need to Be?

With the phase-in of the estate and generation-skipping transfer tax exemption increases under the 2001 Tax Act, an increasing number of estates will be relieved of the consideration of estate and generation-skipping transfer taxes for planning purposes. See Chapter 17 update. Like all tax laws, change is inevitable and predictability uncertain.

A Review of Basic Estate Planning Arrangements (Pages 94-97)

Outright Transfer. Considering the phase-in of estate tax exemptions, an outright transfer may be appropriate if the aggregate total of your assets and those of the transferee (your spouse, child or other person) is less than the estate tax exemption then in effect. Like considerations would be applicable to lifetime outright transfers. U.S. citizenship of a spouse is also a major tax consideration because the unlimited marital deduction does not apply to a non-citizen spouse (see Chapter 17).

Outright Transfer Coupled with a Disclaimer Trust. This approach, allowing the surviving spouse to take outright or to disclaim into a trust (which usually is drafted for the benefit of the spouse), may be appropriate to provide for alternative post mortem planning flexibility based on the then current tax laws and the substantive circumstances concerning the spouse at the time of death. To avoid undesirable tax consequences, your spouse should be the only current beneficiary of a trust funded by a disclaimer and no power of appointment should be granted.

Credit Trust. The amount of a credit trust is generally expressed in a formula funding the trust at the maximum estate tax credit or exemption equivalent. With the phase in of the increased exemptions, all death taxation may be avoided. However, if the trust is for the benefit of children from a prior marriage, care must be taken in expressing the funding formula

by providing for a *cap* or one or more credit trusts. Arbitrary use of the standard formula could result in a maximized tax advantage while unintentionally disinheriting your spouse.

QTIP Trust. This trust is generally coupled with a "Credit Trust" where your estate exceeds the maximum exemption that can be sheltered in the "Credit Trust." Again, with the phase-in, the funding formula needs careful drafting to insure fulfillment of your desires to provide for your spouse. If your spouse is not a U.S. citizen, the "QTIP Trust" requires additional provisions to qualify as a Qualified Domestic Trust (QDOT).

Summary (Page 98)

With the current tax law providing incremental phase-in of increased estate and generation skipping transfer tax exemptions through 2009, a repeal of the estate and generation skipping transfer tax in 2010, and a potential permanent repeal or a reversion to the status of those taxes as effective for 2011, careful drafting, often much more complex than before, will be required. As always, tax driven considerations should be incorporated into your plan only to the extent they do not adversely affect the beneficiaries you desire to benefit, the control you wish to impose after death, and the extent of asset protection you want to provide for your beneficiaries. As tax considerations are also introduced, the complexity of your estate plan increases.

Chapter 20 - Income Tax Consequences at Death

Tax Rates (Page 102)

The 2001 Tax Act reduces income tax rates for individuals, estates, and nongrantor trusts. Beginning in 2001, individuals have a new 10% tax bracket, and the rates in the tax brackets greater than 15% are reduced in phased-in amounts over five years. As with the other changes in the 2001 Tax Act, tax rates will increase to their pre-2001 levels in 2011.

The 2006 tax rate tables for individuals and estates and nongrantor trusts are shown on the next page.

Individuals:			*Estates and Nongrantor Trusts:*		
Tax Rate	***Taxable Income***		***Tax Rate***	***Taxable Income***	
	Over	***Not Over***		***Over***	***Not Over***
10%	N/A	$ 7,550.	10%	N/A	N/A
15%	$7,550.	$30,650.	15%	0.	$2,050.
25%	$30,650.	$74,200.	25%	$2,050.	$4,850.
28%	$74,200.	$154,800.	28%	$4,850.	$7,400.
33%	$154,800.	$336,550.	33%	$7,400.	$10,050.
35%	$336,500.		35%	$10,050.	

The New Income Tax "Basis" (Page 103)

Beginning in 2010, the 2001 Tax Act provides new rules for determining the tax basis of inherited assets. Under the modified carryover basis system, the basis in inherited assets is the lesser of date of death value or the decedent's adjusted basis. Each estate will have a minimum $1.3 million basis increase ($60,000 for nonresident, noncitizen decedents) that can be allocated to assets acquired from the decedent up to their fair market value. Rights to income in respect of a decedent, certain assets that the decedent acquired by gift, and stock or securities in certain foreign entities are not subject to basis adjustments. An additional $3.0 million basis increase is allowed for certain assets passing to a spouse. These rules apply only to the year 2010, unless the 2001 Tax Act provisions are extended.

Chapter 21 - Educational Expenses: Planning for College

1. Education IRAs

- Annual contributions increased to $2,000 per beneficiary. The contribution period is extended from December 31 to April 15 of the following year for individual taxpayers.
- For married couples filing jointly, the phase-out range has been increased to $190,000-220,000.
- Contributions for special needs beneficiaries have been extended past age 18.

- The definition of qualified education expenses is expanded to include qualified elementary and high school expenses, tuition/fees, special needs services, and extended day programs.

2. Section 529 College Savings Plans

- Offer tax-favored method of saving for higher education. A wide range of options are available.
- All provisions that apply to state plans now apply to prepaid tuition programs established by public or private eligible educational institutions.
- All distributions from qualified 529 plans are excluded from gross income to the extent they are used to pay for qualified higher expenses, even if the taxpayer claims a HOPE credit or lifetime learning credit in the same year after December 31, 2003.
- Definition of family members expanded for tax-free rollovers.
- Special gift tax provisions apply.

3. Deduction for Education Expenses

- The new law allows qualified taxpayers to deduct some higher education expenses during a taxable year. This deduction will not be available after 2007.

The above options offer favorable tax benefits in planning for college, but are complex, and tax advisors should be consulted.

Chapter 22 - Planning for the Owner of a Closely-Held Business

Business Interests and Estate Taxes (Page 113)

The 2001 Tax Act repealed the $1.3 million Qualified Family Business Exclusion, effective in 2004.

Extended estate tax payment provisions have been expanded in the 2001 Tax Act to include, at modified levels, certain real estate and investment businesses.

Chapter 23 - Preserving Family Wealth: Tax-Free Transfer of Future Appreciation

The changes to estate taxes under the 2001 Tax Act and the uncertainty that the Act's 2011 sunset provisions create make estate tax planning more complicated than it once was. It is advisable that you contact your tax advisor before embarking on any of the strategies discussed in this chapter.