Preserving Wealth

An interview with local estate planning attorney Robert G. Blue covers the basics of federal and state estate tax laws and how they affect you

Robert G. Blue graduated from Gilman School (1981), the University of Virginia (B.A. 1985) and the University of Virginia School of Law (J.D. 1989). His practice focuses on estates and trusts and estate administration, with an emphasis on advising clients on tax, probate and related issues in connection with the transfer of wealth within families. Blue is a member of the Baltimore Estate Planning Council, the Estates and Trusts Section of the Maryland State Bar Association and the Professional Advisors Council of the Baltimore Community Foundation. He is a member of the Baltimore County Bar Association, the Maryland State Bar Association and the American Bar Association. Bob is admitted to practice in all Maryland courts as well as the United States District Court for the District of Maryland, the United States Court of Appeals for the Fourth Circuit, and the United States Supreme Court. He is a partner at Royston, Mueller, McLean & Reid, LLP in Towson, Maryland.

Q: With the federal estate tax scheduled for repeal next year, do we really need to be concerned about estate taxes or other taxes on the transfer of wealth?

A: It is difficult to predict anything from Congress these days, but there is a near consensus view among those closely following the situation that Congress will not permit repeal to occur as scheduled under the current law [the Economic Growth and Tax Relief Reconciliation Act of 2001]. Senate Bill 722 introduced by Senator Baucus in March of this year would make permanent the current $3.5 million exemption as adjusted for inflation. My guess is that this bill or one similar to it will be signed into law before repeal takes effect, maybe even by the end of summer.

But even if the federal estate tax were to go away, we in Maryland still have to contend with the separate state estate tax, which has an exemption level of only $1 million. So if you are unmarried at the time of your death and own assets including life insurance having a value of greater than $1 million, your estate will owe some tax to Maryland's Comptroller. The highest rate of tax that can be assessed is 16%, but Marylanders who die with assets of $5 million or less will pay at a marginal rate lower than 8%. Still, as an example, an unmarried Marylander with an estate worth $3.5 million would pay the State of Maryland $229,200 even though no federal estate tax would be due.

Q: What advice do you have for those who likely will not have to pay federal estate tax but will have to pay estate tax to the State of Maryland?

A: Any advice would have to be given on a case by case basis. For instance, one way to reduce Maryland estate tax is to give away assets to family members or charitable organizations during your lifetime. Maryland, unlike the federal system, does not include lifetime gifts to family members when calculating the estate tax. But I would not recommend this approach to a young couple who still have mortgage and college education payments ahead of them.

Regardless of what phase of life you are in, married couples with combined assets over $1 to $2 million should consider having Wills which create or allow for the creation of a Maryland-only marital trust. At the death of the spouse who is first to die, the assets funding such a trust are not taxed because the trust qualifies for the unlimited marital deduction under Maryland law. So, it is a good idea for these couples to have Wills which provide that the decedent's assets up to the Maryland exemption amount [currently $1 million] pass to a traditional shelter trust, with the balance of the estate, up to the federal exemption amount [currently $3.5 million], passing to a Maryland-only marital trust, of which only a spouse may be a beneficiary. With proper elections made on the estate tax return, the assets funding the traditional shelter trust and the Maryland-only marital trust will escape Maryland taxation at the death of the spouse who is first to die, and will escape federal taxation at the surviving spouse's death, no matter how much the assets appreciate in the interim. However, whatever remains in the Maryland-only mari-

tal trust will be taxed in the surviving spouse's estate, assuming that amount plus the assets in the surviving spouse's name alone exceed that Maryland estate tax exemption amount and the surviving spouse dies a Maryland resident.

Q: Why not suggest moving to another state?

A: Then I wouldn't have any clients [laughs]. No, seriously, for clients who have a second home in Virginia or Florida, where there is no state estate tax, there is a significant potential for estate tax savings to be gained from a move. But a good number of my clients have lived in Maryland most of their lives, have children and grandchildren here and, no matter how large the savings, would rather live out their golden years in Maryland than move to a state where they would be away from family and friends.

Q: It's no secret that this economy is the worst many of us have seen, and many people feel that their estate tax problems have been taken care of by the falling markets. Is this really a time to be thinking about making changes to your estate plan?

A: It depends. For those who have not adapted their plan to account for the de-coupling of the federal and Maryland estate tax exemption amounts, I think an update is critical if the possible payment of estate taxes is an issue. And especially for those with large, taxable estates, the current environment presents an excellent, perhaps historic, opportunity to shift wealth to younger generations. For instance, there has never been a better time to transfer family homes to children, either through an intrafamily loan or a qualified personal residence trust, since the rates published monthly by the Treasury Department for these types of transactions are at historic lows. Similarly, with equity values so low, this is an opportune time to consider a GRAT [grantor retained annuity trust]. Under such a trust, an individual can pass appreciation of assets over the trust's term annually exceeding the Treasury's published rate at the time of funding [currently 2.4%] to family members with little or no gift tax consequence. In a similar vein, an individual can transfer assets to a charitable lead annuity trust whereby a charity receives annual payments for a certain number of years and family members receive the appreciation above and beyond the published "hurdle rate" at the end of the trust's term.

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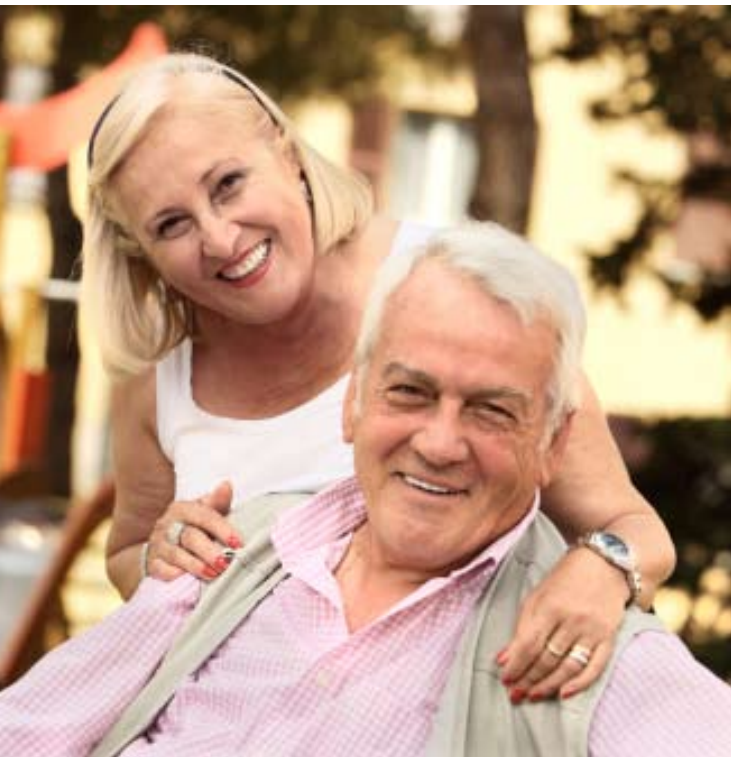

Q: Do you have any simple recommendations for people facing a potential estate tax bill?

A: I always encourage clients with larger estates to make outright gifts to children and others where the children or grandchildren are mature enough to handle such gifts. If they are not, such gifts can be made to trusts benefitting those family members. Federal law currently requires a donor to file a gift tax return if the total amount given to a donee in a calendar year exceeds $13,000. So, certain clients like to take advantage of these "annual exclusion" gifts—the gifts don't need to be reported and they don't count against the lifetime gift tax exemption amount, which currently is $1 million.

Q: What role does life insurance play in estate planning?

A: I would take up all of your magazine's pages explaining life insurance. I should mention briefly, however, that many married clients like the idea of placing a second-to-die policy in a trust, which if structured properly, has the effect of keeping the death benefit out of the couples' estates for estate tax purposes. This way, assets can pass to family members free of estate tax and can be viewed as a way to replace the estate taxes paid by the couple on assets that were includible in their estates. Due to the possibility of estate tax repeal during the Bush years, many clients put this type of planning on hold, but with the prospects of repeal becoming dimmer with each passing day, I've witnessed an increased interest in this estate planning tool.

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