REPORTER

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I N S I D E

Is Your Estate Planning Up to Date?

By Marcia C. Fidis

Clients frequently ask "How often should we review our estate planning?" We generally advise meeting with your attorney to review your estate planning every five years at a minimum. However, due to significant changes in the estate tax laws in the last few years, as well as amendments to regulations governing retirement plan assets, a more frequent review might be appropriate. Years go by, your circumstances alter, your beneficiaries change, the tax law changes, your assets change - all are reasons you might need to revise your estate planning.

Here is a checklist to help you review the state of your planning.

1) Will. Have you changed the way you want to leave your assets from that provided in your will? Have your children's circumstances changed? Have your thoughts about how to provide for your beneficiaries changed? Since you signed your will do you have greater or fewer assets which, along with the change in the tax laws, might suggest a change in the tax planning in your will?

2) Estate Taxes. Do the combined assets of you and your spouse (or your individual assets if unmarried) exceed the estate tax exemption amount? ($1,000,000 for 2003; $1,500,000 for 2004 and 2005).

3) Power of Attorney. Have you changed your mind about the appropriate person to manage your financial and property affairs in the event of disability? Is your power of attorney more than five years old? Have you established any 529 Education Plans for beneficiaries that are not covered in your power of attorney? Do you have retirement assets that are not covered in your power of attorney?

4) Advance Health Care Directive. Do you need to sign an advance directive (including a living will)? Have you changed your mind about the person who should make your health care decisions in the event you cannot? Have your views about artificial life support changed?

5) Revocable Trust. Does your revocable trust need to be reviewed? Does it need to be properly funded to accomplish the purpose of removing assets from probate? Do you own real estate outside of your home state? If your health is fragile, do you need to consider a revocable trust for disability management?

6) Asset Protection. Do you wish to protect your assets from potential creditors? Are you concerned about protecting an inheritance you leave to your children from divorce, creditors or dissipation from lack of management? Do you wish to protect assets you leave a spouse against a subsequent marriage of that spouse so that the assets eventually pass to your children or other beneficiaries of your choice?

7) Closely Held Business. Do you have a closely held business that you want to pass to your children at death with minimum disruption and disputes among the beneficiaries? Do you want to permit a valued employee to purchase and take over the business if you die?

8) Life Insurance. Do you need to review the beneficiaries on your life insurance policies to be certain that they are consistent with your estate plan? Do you need to review your insurance policies to see that they are performing as anticipated when you purchased them, or to see if there are better more cost effective products on the market? Do you need an insurance trust to protect proceeds from estate taxes or to hold policies that are needed to pay estate taxes that may be due on your death?

9) Trusts for Your Children. Are your children older, wiser, more stable than when you first established a trust for them so that they should be involved in managing their own assets? Or do they now have problems with finances, cred-

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The Pasternak & Fidis Reporter

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2003 Tax Law Summary

A BRIEF OVERVIEW OF SOME OF THE PROVISIONS OF THE NEW TAX LAW

by N. Alfred Pasternak

Here is a brief overview of some of the provisions of the new tax law, officially named the "The Jobs and Growth Tax Relief Reconciliation Act of 2003" to reflect its intended purpose of stimulating the economy.

The new law accelerates previously scheduled individual income tax rate cuts and grants short-term tax incentives for certain types of business investment. In general, the main beneficiaries are individual investors, small businesses planning to invest in new equipment or off-the-shelf computer software, and middle income families with minor children. Almost all individuals who pay federal income tax will experience some tax reduction, and wage-earners should see some of this reflected in lower withholding taxes during the second half of 2003.

15% TOP RATE ON DIVIDENDS, CAPITAL GAINS

For many individuals, the new law makes a deep cut in the tax on dividends received in 2003 through 2008. Instead of being taxed at an individual's top bracket (up to 35%) qualified dividends will be taxed at a maximum of 15% (less for taxpayers in the two lowest brackets). Thus, for example, $6,000 of qualified dividends would incur a tax of $900 instead of $2,100. In general, dividends eligible for this preferred treatment must come from domestic corporations or "qualified foreign corporations," including corporations organized in U.S. possessions, foreign corporations whose stock is traded on an established U.S. securities market, and certain other foreign corporations to be designated based on criteria set out in the new law. Complementing the dividends tax cut is a cut in the top rate on long term capital gains to 15% (less for individuals in the two lowest brackets) through 2008. Unlike the dividends cut, however, the effective date of the capital gains cut is not retroactive to the beginning of tax year 2003. Instead, the new rate generally applies to sales on or after May 6, 2003. The 20% rate applies to long term capital gains realized before that date. Note that the new law reduces the top rate on dividends and long term capital gains to 5% for taxpayers in the two lowest income tax brackets (i.e., 10% and 15%) through 2007 and to 0% in 2008. Taxpayers contemplating gifts to family members in these income tax brackets need to take the new top rates into account in selecting the gift property.

INCREASED SECTION 179 EXPENSING AND BONUS DEPRECIATION

The new law provides two temporary incentives aimed primarily at small business. One provision retroactively increases the "Section 179 expensing" limitation to $100,000 (from $25,000) provided the total cost of all such property does not exceed $400,000 for taxable years beginning after December 31, 2002. Also, this provision expands the category of eligible property (generally defined as tangible property other than real estate, such as machinery and equipment) to include off-the-shelf computer software.

The $100,000 and $400,000 amounts will be adjusted for inflation in taxable years beginning in 2004 and 2005. The law is scheduled to revert to the old rules, however, in taxable years beginning after December 31, 2005.

The other incentive provision increases "bonus" first-year depreciation to 50% (from 30%) of the adjusted basis of qualified property acquired and placed in service after May 5, 2003, and before January 1, 2005 (January 1, 2006 for self-constructed property). Examples of such property include equipment, machinery, leasehold improvements, furniture, car, trucks, and off-the-shelf computer software.

INDIVIDUAL INCOME TAX RATE CUTS

The new law, retroactively to the beginning of tax year 2003, reduces the top four rate brackets (27%, 30%, 35%, and 38.6%) to the levels previously scheduled to take effect in 2006 (25%, 28%, 33%, and 35%).

Also, the new law retroactively, albeit temporarily, accelerates the expansion of the 10% bracket by increasing the level of income taxed at that rate in taxable years 2003 and 2004. For 2003, joint filers and surviving spouses will pay 10% on the first $14,000 (versus $12,000) of taxable income and single filers will pay at that rate on the first $7,000 (versus $6,000). For 2004, the $14,000/$7,000 amounts are to be adjusted for inflation. But the 10% bracket will revert to the previous levels of $12,000/$6,000 from 2005 through 2007, return to the $14,000/$7,000 levels for 2008, and be adjusted for inflation after 2008.

"MARRIAGE PENALTY" RELIEF

Although the 2001 tax cut legislation included "marriage penalty" relief, it deferred implementa-

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Premarital Agreements and Postmarital Conduct

by Linda J. Ravdin

Premarital agreements have become an increasingly popular means for parties to an upcoming marriage to determine their property rights in the event of divorce or upon death. A premarital agreement can permit parties to retain exclusive rights to their separate property and may predetermine each party's rights to property acquired by the other spouse during marriage. However, actions a party may take after the marriage may alter rights under the agreement, for better or worse. Such actions may result in an abandonment of the agreement, or they may strengthen the validity of the agreement. Their actions may leave the agreement intact but alter their financial rights in a significant way.

ABANDONMENT

Conduct that may raise a question about whether parties intended to abandon the agreement includes:

Termination of Engagement Followed by Reconciliation. When a party calls off the wedding after execution of a premarital agreement, a court could conclude the parties intended to repudiate the agreement. Therefore, if they later reconcile and decide to marry they should sign a ratification of the previous agreement or a new agreement, or they should put in writing their intention to marry without an agreement.

Conduct Inconsistent with Continued Viability of Agreement. In a 1995 Ohio case, *Simoni v. Simoni*, the husband transferred his assets into joint names during the marriage. He failed to disclose to his estate planning attorneys that he had a premarital agreement and it was not mentioned in his will or trust. The court held his conduct during the 18-year marriage showed he intended to abandon the agreement.

Breach of Agreement. When one party so completely breaches an agreement as to defeat the very purpose of the agreement, a court may decide the parties intended to abandon the agreement. By contrast, a simple breach of the agreement's terms does not constitute an abandonment if the agreement can be enforced through ordinary contract remedies. Whether a breach is substantial may be open to controversy. A breach may therefore put the entire agreement at risk.

Oral Revocation Coupled with Conduct. Even though an agreement says it may not be orally modified or revoked, when a party states an intent to rescind the agreement and couples the statement with conduct consistent with that intent, a court may say the agreement was abandoned. For example, in a 1987 Florida case, *Gustafson v. Jenson*, the court decided an oral agreement to reconcile conditioned on termination of a premarital agreement combined with physical destruction of the agreement was an abandonment.

Disadvantageous Change of Position. A party's post-marriage actions detrimental to his or her own financial interests will not cause an otherwise valid agreement to be deemed abandoned. For example, when an agreement provides for a waiver of alimony, that waiver will be upheld even if a spouse makes career sacrifices for the family or to further the other spouse's career. It would be appropriate for a spouse to insist on an amendment to a premarital agreement to more fairly allocate the financial burdens of their joint decisions before making a major change that may affect that party's financial security.

RATIFICATION

Just as parties' conduct may effect an abandonment of an agreement, their post-agreement conduct may ratify, and, therefore, strengthen the enforceability of the agreement. A party who accepts the benefits of an agreement has ratified it. For example, in *Nanini v. Nanini*, a 1990 Arizona case, the wife amassed a considerable separate estate which she took pains to keep secret from the husband. Similarly, in *Hartz v. Hartz*, a 1967 Maryland case, the wife executed deeds of trust on her sole signature, something she could not have done without the premarital agreement. In both cases conduct consistent with the party's rights under a premarital agreement negated a later claim of invalidity.

Where the agreement requires the wealthier spouse to take certain actions during marriage, such as to retitle property, establish joint bank accounts or beneficiary designations, make cash transfers or make provisions in a will, the party should carry out these obligations completely. Doing so, and the other party's acceptance of the benefits of the agreement, can significantly insulate the agreement from a successful challenge.

TRANSFERS, CHANGES IN FORM, COMMINGLING, RETITLING, AND INTERSPOUSAL GIFTS

Parties to an agreement may effectively modify the terms of a premarital agreement, without necessarily abandoning the agreement as a whole, by commingling, retitling or gifting property during the marriage which the agreement otherwise permits them to keep separate. This may occur as a natural evolution during the marriage.

Commingling. Commingling occurs when property or money from various sources is so intermingled that it becomes indistinguishable. If a party wishes to maintain sole rights to separate property, he or she should generally avoid merging separate and marital funds into the same bank accounts and securities.

Titling Property Jointly. An agreement does not preclude a party from being more generous than required. Thus, when a party titles property jointly which would otherwise be separate property under the terms of a premarital agreement, such a transfer will generally constitute a gift. Often a party will title a premarital home jointly in order to provide for the other party at death. But gifts cannot be taken back if the marriage fails. One option is for the owner to provide for the surviving spouse in a will or trust. Or the premarital agreement could require a spouse to deed back a jointly titled home to the original owner in the event of divorce.

Use of Funds from Joint Bank Accounts. When parties establish a joint bank account, they authorize each other to withdraw and use funds on deposit regardless of their relative contributions or who would have the right to the funds at divorce or death. A spouse who made a greater contribution to such an account will not have a claim to reimbursement even if the other spouse's spending was excessive.

Linda J. Ravdin is the author of *TM849 Marital Agreements* (Tax Management Inc. 2003), a guide for attorneys to negotiating and drafting premarital agreements as well as postmarital and domestic partnership agreements.

Failure to Keep Adequate Financial Records. When the agreement provides for determination of parties' property rights based on the source of financial contributions, each party must keep adequate financial records to be able to establish his or her claim. When a party fails to maintain records the claim may fail. Similarly, when the agreement provides for parties to retain separate property and to share property acquired during marriage, they will need to keep fairly detailed records of sales, transfers and changes in form of their separate assets to clearly track which is which. A lack of adequate records may result in a separate asset becoming a marital asset.

One Party Controls Finances. Where an agreement determines parties' rights at death or divorce according to title, a party's control over family financial affairs may work to the disadvantage of the other party. For example, in *Martin v. Farber*, a 1986 Maryland case, the husband turned all his paychecks over to the wife who made investments in her name alone. The parties' premarital agreement, executed in 1939, gave the husband no rights to the wife's estate at death. The court imposed a constructive trust, but it limited the scope of the trust to those assets the husband was able to trace to his paychecks.

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2003 TAX LAW SUMMARY

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tion until taxable year 2005, at which point the relief was to be phased in over several years. The new law temporarily accelerates this relief in taxable years 2003 and 2004 by:

> Expanding the 15% bracket for joint filers to 200% of the amount applicable to single filers. Beginning in 2005, the previous schedule will apply (i.e., 180%, 187%, 193% in 2005-2007, 200% in 2008 and thereafter); and
>
> Increasing the standard deduction for joint filers to 200% of the amount applicable to single filers. Beginning in 2005, the previous schedule will apply (i.e., 174%, 184%, 187%, 190% in 2005-2008, 200% in 2009 and thereafter).

CHILD TAX CREDIT INCREASE

The new law temporarily increases the maximum child tax credit to $1,000 (from $600) per child for taxable years 2003 and 2004. Beginning in 2005, the previous schedule will apply (i.e., $700 in 2005-2008, $800 in 2009, and $1,000 in 2010. After 2010, the amount of the credit will return to $500).

Any taxpayer who was allowed a child tax credit for 2002 may receive an advance payment of the increased credit amount for 2003 (up to $400 per child) before October 1, 2003, based on information on the taxpayer's 2002 return.

Note that the new law did not change the phase-out rule whereby the child tax credit amount is reduced at the rate of $50 for each $1,000 (or fraction) by which a taxpayer's "modified adjusted gross income" exceeds certain threshold amounts. The phase-out range begins at $110,000 for joint filers; $55,000 if married filing jointly separately; and $75,000 if single or head of household.

ALTERNATIVE MINIMUM TAX RELIEF FOR INDIVIDUALS

The new law temporarily increases the alternative minimum tax exemption amount for 2003 and 2004 by $9,000 for joint filers and surviving spouses and by $4,500 for single filers and married filing separately. Thus, the exemption amounts in those years will be $58,000 for joint filers and surviving spouses, $40,250 for single filers, and $29,000 for married filing separately.

These increased exemption amounts are estimated to substantially reduce the number of individuals subject to the alternative minimum tax in 2003 and 2004.

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PASTERNAK & FIDIS, P.C.

N E W S

Jennifer McCaskill, an Associate in the Divorce and Family Law Group, has been elected to the Board of the Young Lawyers Section of the Fairfax Bar Association.

Marcia Fidis and Jan White will be teaching and leading workshops at the Maryland Institute for Continuing Professional Education of Lawyers (MICPEL) Divorce Tax Workshop for divorce attorneys in October, 2003.

Linda Ravdin has become the Chair of the Publications Development Board of the American Bar Association Family Law Section. She was also re-appointed as a member of the Publishing Board of the ABA Law Practice Management Section.

Nancy Fax served as the moderator at the second annual program and reception of the Montgomery County Community Foundation's Professional Advisors Council held on October 9, 2003. Nancy is the Chair of the Council.

2003 TAX LAW SUMMARY

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Beginning in 2005, however, the exemption amounts are scheduled to drop significantly: to $45,000 for joint filers and surviving spouses, $33,750 for single filers, and $22,500 for married filing separately. Hence, absent future Congressional action, the alternative minimum tax could become a major tax "trap" for many individuals in 2005.

FUTURE TAX LEGISLATION

Congress has plenty of unfinished tax legislative business remaining.

For example, military tax relief legislation has received widespread support, as has a measure to permit non-itemizers to deduct charitable contributions. Legislation that would make major changes in the U.S. international tax rules has been pending for some time. Several pending initiatives are intended to combat tax shelters.

Proposals that would significantly affect the tax treatment of retirement plans and employee benefits may receive serious consideration later this year. Moreover, many temporary provisions contained in previous legislation will expire in 2003 unless Congress acts to extend them. Examples include the Work Opportunity Credit and the Welfare-to-Work Credit. Finally, many lawmakers are urging further permanent tax cuts (including death tax repeal) and additional business investment incentives.

Unfortunately, predicting which, if any, of these measures will be passed is difficult at best. Please feel free to contact us for additional information in order to maximize your benefits under the new law.

IS YOUR ESTATE PLANNING UP TO DATE?

—continued from front cover

itors, spouses etc. that you had not contemplated when your estate plan was drafted? Do you think that other persons might be better choices to serve as trustees under your estate plan? Have any trustees you named died, become disabled, moved away or otherwise become unable to serve?

10) Trusts Established for You. Are you the beneficiary of a trust from which you would like to receive larger distributions? (see "Attention Trustees and Beneficiaries" on page 2 of our June, 2003 newsletter). Are you the beneficiary under someone else's will of assets you would rather have pass to your children to save estate taxes? Is the trustee of your trust failing to perform to your satisfaction?

11) Positioning Your Assets. Have the values of your assets changed since your estate plan was completed? Are the assets substantially larger or do they consist of very different assets than when you signed your estate planning documents? Do you need to review your assets to see if each spouse has sufficient assets of the right type to take advantage of the increased estate tax exemption ($1,000,000 per person this year increasing to $1,500,000 for 2004 and 2005)?

12) Retirement Assets. If you have substantial retirement assets, do you need to have your beneficiary designations reviewed to be certain that you have taken advantage of the new IRS regulations providing additional opportunities to defer income taxes on those assets after your death?

13) Charitable Beneficiaries. Do you have charitable beneficiaries that you want to benefit that are not mentioned in your will? If you have charitable beneficiaries, do you need to review whether to maximize income tax savings by providing for them out of retirement assets rather than under your will now that there are more options for naming beneficiaries under IRS regulations?

14) Modified Administration (Maryland Residents). If your will was prepared more than four years ago, does it need to be reviewed to see if changes should be made to take advantage of Maryland's simplified probate proceedings ("modified administration")?

15) Disability Planning. Is physical or mental disability for you or a family member now a greater concern to you than when your planning was completed? Do you need to review any provisions for beneficiaries with a disability to be sure that assets you leave them are protected so as not to disqualify the disabled beneficiary from receiving governmental benefits?

If you answered "No" to all the questions, then most likely your estate plan still meets your needs. If you answered "Yes" to any questions, it might be time for a review to address those issues.

PREMARITAL AGREEMENTS AND POSTMARITAL CONDUCT

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Because the wife came to the 44-year marriage with inherited assets, the husband may well have had a difficult time establishing his claim. The constructive trust remedy after the damage has been done is a poor substitute for prevention of the problem in the first place. A party who is entering into a marriage with little or no property and no rights except by title should retain title to his or her own assets and income to the full extent possible.

Dissipation and Transfers. Premarital agreements commonly provide that parties will have the freedom to dispose of their property during marriage as they wish. A party may spend unwisely or make excessive gifts to children. Where the agreement provides for the less wealthy spouse to receive a percentage share of property at divorce or death, that party should be aware of the effect of post-execution activities on the pool of assets from which that spouse's share will be determined. When the agreement provides that the less wealthy spouse will receive a share of a specific asset, such as an interest in real estate, the agreement should limit the other spouse's ability to reduce the value of that asset, for example, by borrowing against the equity, so as to defeat the rights of the disadvantaged party.

CONCLUSION

Decisions parties make after marriage can alter their rights under a premarital agreement. Most premarital agreements divest the courts of any authority to decide how property should be allocated upon divorce or death. Courts have no power to rewrite the parties' contract even when the result is unfair or a spouse failed to appreciate the consequences of a decision. Parties to a premarital agreement should therefore determine how postmarital conduct will affect their rights before they make irrevocable decisions.

PASTERNAK & FIDIS, P.C.

N E W S

P & F welcomes Marilyn C. Green as a paralegal in the Estate Planning and Administration Group. Recently returned to the Washington, D.C. area from Columbus, Ohio, Marilyn brings over 15 years of experience administering estates and trusts in Maryland, New York, and Ohio. She has a B.S. degree from SUNY, Binghamton and an Honors Certificate in Estates and Trusts and Legal Research from the paralegal program at Adelphi University.

We're growing! P & F will begin construction this month on expanded space in the Fairmont Building. We hope to be moved into our larger quarters by year's end.

Congratulations are in order for Associate Jennifer McCaskill and Paralegal Sharon Hopkins who were both married on the same day in September, 2003. Jennifer's wedding took place in Washington, D.C. while Sharon's family and friends assembled at the Grand Canyon in Arizona to celebrate. Jennifer will continue to be known as Jennifer McCaskill, while Sharon will now be known as Sharon L. Coop.

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