

NEWSLETTER

Interest Rate of .81%??!!

How to Plan for the Exceptionally Low January Interest Rates



In late December, the Internal Revenue Service announced its Applicable Federal Rates (AFRs), the interest rates that are the minimum that taxpayers can charge, for the month of January 2009. The drop in rates was unbelievable! The January rate for Grantor Retained Annuity Trusts (GRATs) moved from 3.4% in December to 2.4% in January. In other words, you now only have to beat an annual return of 2.4% to have something left over to move, gift-tax free, to your children. To put this in perspective, the rate in January 1991 was 9.8%.

Even more amazing, the rate on loans to children (or their trusts) moved down to .81% for loans of three years or less. We have clients who are currently considering making loans to their children or trusts for their kids, with the view to having them invest over the next three years and “arbitrage” the difference—that is, if the children can out-earn this low rate, then the extra return will end up in their hands, estate and gift tax free! If you want to go even further out (up to nine years), the rate increases, but only to 2.06%.

Welcome to 2009!

Here's hoping for a less stressful year! We hope you had a nice, relaxing holiday season and that you are ready to do some tax planning to start off the New Year.

Rarely do we get good news from the Internal Revenue Service and Congress in such a short period of time, but both did just that at the end of the year and we want to pass these developments on to you.

We hope you enjoy our quarterly letter.

Please let us know if you have questions or ideas for improving it.

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THE BENEFIT OF PLANNING IN A LOW INTEREST RATE ENVIRONMENT, CONTINUED

There are many ways to take advantage of this super low interest rate environment. The easiest, but one of the most effective, is to simply loan funds to a trust for your children. The trust would be structured so that you would pay the tax on its income, but the appreciation above the interest rate would go to your children. So long as you use the proper IRS-prescribed rate mentioned on Page 1, the result can be moving almost all the appreciation to your children without gift tax.

Another option is to sell an asset to a trust that is set up to benefit your children. The trust would promise to re-pay the loan over a specified period and, if the asset appreciated more than the interest rate, then again the appreciation over that rate would go to your children gift tax free. For example, suppose you have a private equity investment that is beaten down due to the market conditions of the last year. However, you are optimistic it will turn around and be a big winner. You could sell this investment to a trust for your children and they would get almost all the appreciation gift tax free. There are a few catches—you will need to make sure there is enough value in other assets to warrant a loan and you will have to get a third party appraisal of the asset from a

qualified appraiser, but nonetheless this could be a powerful tool for your family.

A third option is the “Jackie Onassis” trust—a charitable lead trust. You would set up a trust that pays an annuity to a charity, with the remainder paid after a period of time to your children. If you pay enough return to the charity (and “enough” is considerably lower than it used to be), then the amount at the end going to children can be given with a substantial discount for gift tax purposes.

Many clients are hesitant about doing any gifting now, having seen their portfolios shrink so much last year, but if you take the long view this could be a great time to plan for your children.

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CHRISTMAS PRESENT FROM CONGRESS AND THE PRESIDENT

President Bush signed “The Worker, Retiree, and Employee Recovery Act of 2008” on Dec. 23rd. Among other things, the Bill provides that taxpayers who would have been required to take an IRA distribution in 2009 may postpone that distribution. It also eliminates required distributions from 401(k) plans, as well as other defined contribution plans (such as money purchase pension plans and profit sharing plans) and also 403(b) and 457(b) plans. If you were required to take a distribution in 2008, that was not waived. In addition, if you reached age 70 1/2 in 2008 and if you did not take your first distribution in 2008 but were waiting until April 1, 2009, as permitted, for the first payment, then you must still make the first distribution by April 1, 2009.

If you turn 70 1/2 in 2009, then it is even more complicated.

You will have until 12/31/2010 to take your distribution with respect to 2010, but you can skip your 2009 distribution.

Keep in mind that you can also make a contribution directly from your IRA to a public charity in 2009 (subject to limits) and it will not count as income, yet it will still count as a distribution. In light of the new law on skipping distributions in 2009, however, this idea’s value is less attractive.

ESTATE PLANNING RED FLAGS



Danger! *New Jersey's Estate Tax does not match up with the Federal--*
Curve Ahead! *Your estate could end up paying an extra \$229,200!*

You may be tooling down the highway of life, thinking your estate plan is all in order, but then hit a curve called the New Jersey Estate Tax. We won't call this "dead man's curve", but you will want to hold on!

New Jersey, along with many other states, woke up after the Federal Estate Tax was changed early in the Bush Administration and discovered that it was going to be missing a lot of estate tax revenue due to the Federal Government no longer permitting the states to just levy a tax at its expense. Instead of granting a credit on the federal estate tax return for state death taxes, the Federal Government got wise and just permitted a deduction. This saved the Federal Government a lot of taxes, but at the expense of the states.

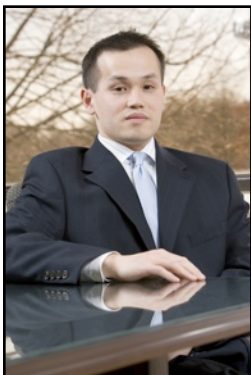
In response, New Jersey changed its estate tax to only exempt the first \$675,000 of assets from its taxation. That compares to the Federal exclusion amount of \$3.5 million for 2009. Thus, if a New Jersey resident passed away and left assets to someone other than a spouse, the IRS will exempt the first \$3.5 million from tax, but New Jersey will only exempt the first \$675,000.

We often see estate plans in which clients have arranged to use

up the full amount of the unified credit (\$3.5 million), by setting it aside in a special trust designed to provide income for a spouse, but still soak up the credit. The problem, however, is that in New Jersey this will result in a death tax of \$229,200, up from \$99,600 in 2008.

It may make sense to still fully fund this trust (called a "Credit Shelter Trust"), because the benefit of sheltering more assets from Federal Estate Tax may outweigh the cost of paying New Jersey, but you still should consider drafting your will so as to permit the flexibility to either put \$675,000 in trust and avoid all taxes, or put the whole \$3.5 million in trust and maximize the use of the Federal unified credit.

Even if paying New Jersey taxes does not bother you (and you would be in a minority on that one!), you may still want to review your existing will and your portfolios, as you may now be automatically leaving \$3.5 million in a credit shelter trust due to the increase in unified credit in 2009. You will want to make sure both spouses have enough in assets to fund this \$3.5 million credit amount in each estate, if that is what you really want.



LING LAU ADMITTED AS PARTNER

The Partners of Stern and Kilcullen, LLC are pleased to announce that Ling Lau has been admitted as a Tax Partner, effective 1/1/09. Ling joined the Firm in 2001 and has extensive experience in corporate tax reorganizations, trusts and estates matters and partnership operations. Ling may be reached at 973-535-2631 or at llau@sgklaw.com.

SALE TO A GRANTOR TRUST

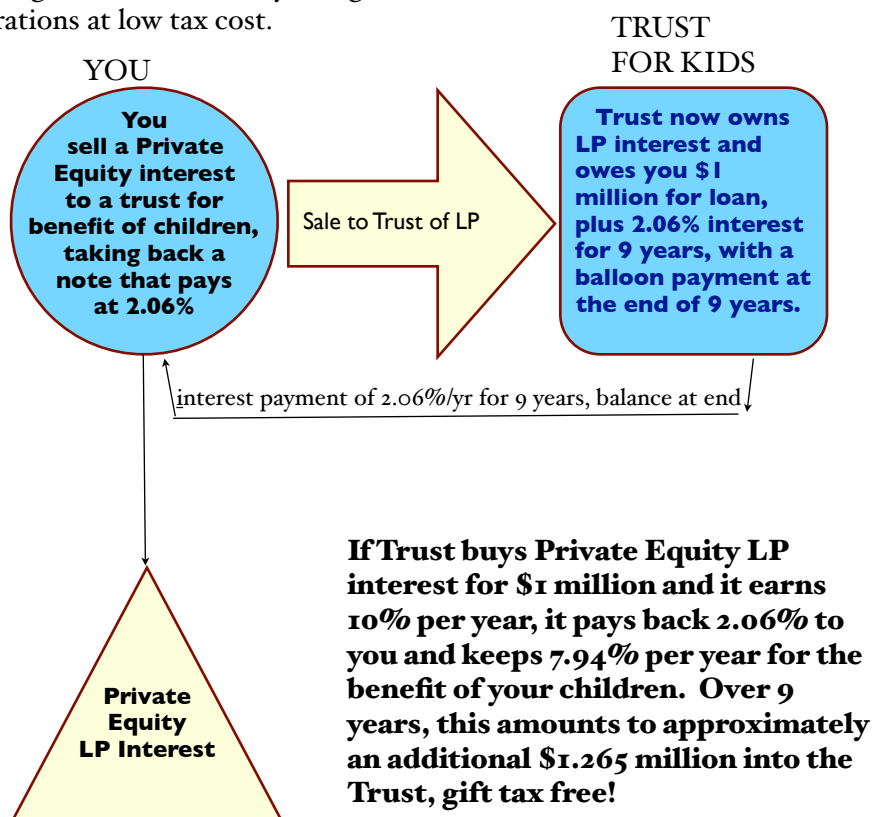
As mentioned on our first page, one technique to take advantage of low interest rates is to sell an asset to a trust for your children (or even for all future generations).

To do this, you would take an asset you think will appreciate significantly. This asset will be sold to a trust that is to benefit the children, with you taking back a note. If set up correctly, this trust will be ignored for income tax purposes, so no gain for income tax purposes will take place, and thus no tax will be due. However, for estate and gift tax purposes, the sale will be respected if done correctly. As a result, the appreciation over the low interest rate (.81% for short term loans, 2.06% for loans over 3 and under 10 years) will go to the trust gift tax free. In effect, almost all the appreciation will go to the trust for your children with no gift tax cost.

There are a few points that need to be considered. The trust must be adequately capitalized well before the sale (no one knows exactly what that means, but it should be funded with what an independent third party would consider adequate capitalization). If the asset that is sold is not publicly traded, then an appraisal from a third party valuation firm is a necessity. The term of the loan needs to be considered--a short loan may not leave enough time for the appreciation to take place, but a long term loan carries a higher interest rate. Lastly, the interest should be paid each year, even though principal can be paid off at the end of the loan (a "balloon payment"), so you'll need

to have enough cash in the trust to make interest payments.

While the GRAT idea that we wrote about in our last newsletter has the benefit of statutory approval, there is no statute that authorizes this idea. So, the rules are not as clear and the risk is higher. If your valuation is too low, you risk generating a taxable gift. Nevertheless, it is a valuable idea for moving assets to younger generations at low tax cost.



A WORD FROM THE JUDGE

**REFLECTIONS ON 2008**

We attorneys get very busy and sometimes fail to reflect on changing events. So I think it is appropriate to look back on the past year as we begin the New Year and discuss how we at Stern and Kilcullen, LLC dealt with all the changes of 2008.

STEADY GROWTH

In the past year, our Firm added eight new Partners, including an entire Real Estate Practice made up of Tom Cohn, Nate Wolf and Paul De Lisi. They came in October and hit the ground running!

Jim Elliott joined us from Merrill Lynch as a Tax Partner in March, 2008. He brought a high net worth tax practice that matches up well with our existing clients.

Andy Bosin came in March, as well. He specializes in commercial litigation and was involved in a very large case immediately and has not slowed down since.

Steve Plotnick joined in March from Lowenstein Sandler, where he specialized in capital markets and financial industry litigation. He's been invaluable in handling various cases that are incredibly complex and demanding of his time.

Aidan O'Connor joined in July, bringing years of experience from the United States Attorney's Office,

as well as from practicing as a corporate trial attorney on Wall Street.

Also, as mentioned on Page 3, we have just admitted Ling Lau as a Tax Partner. We think he'll make a terrific partner.

CLIENTS

While it is not appropriate to discuss confidential client matters, it is appropriate to tell you, our clients, how much we appreciate your loyalty to us. We know you have choices in your legal representation and we appreciate your faith in us.

THE FUTURE

If 2008 taught us anything, it is that you cannot predict the future! Even with that in mind, I would still like to offer a few thoughts on 2009.

We see the Estate Tax changing in the first year of the Obama Administration. We don't think it will go away in 2010 and spring back in 2011--instead we think there will be a more permanent solution that will take effect in 2010. We'll keep you informed of these changes as they happen.

We think that the fall out from all the failures of the Wall Street securitizations will keep courts and lawyers busy for some time to come. The real cost, though, will be added regulation, starting in 2009. We plan to help you navigate these changes and defend yourselves.

Finally, it is our wish that you will have a healthy and prosperous New Year!

Judge Herbert J. Stern

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