

# Estate Planning Bulletin

## Estate Planning After The 2010 Tax Act *What You Need To Know And Do Now*

As discussed in our December 2010 Estate Planning Bulletin, the Tax Reform Act of 2010 (the "Act"), which was enacted December 17, 2010, made the most significant changes in rates and exemptions for the estate, gift, and generation-skipping transfer ("GST") taxes since the last major tax reform act in 2001. Accordingly, all estate plans should be reviewed early in 2011 to determine whether the plan will work as intended under the new Act. Persons who would like to discuss how the new Act affects their specific situations and existing estate plans should contact a member of the Estate Planning Group of Vedder Price P.C.

### ***Executive Summary***

The following is an executive summary of the most notable effects of the new law; a more detailed discussion of each can be found inside this Bulletin:

- ***Impact Of Tax Act On Married Couples' Estate Plans.*** Many married couples have estate plans designed around a formula that gives the estate tax exempt amount to one trust and the balance of the estate to the surviving spouse. Existing estate plans should be reviewed and possibly adjusted to reduce the impact of the wild fluctuations in the estate tax exemption.
- ***Portability Of Estate Tax Exemption Between Spouses, While Helpful, Is Rarely The Best Solution.*** The Act includes new rules allowing a predeceasing spouse to transfer unused gift and estate tax exemption to the surviving spouse. However, more traditional planning using a credit shelter or "bypass" trust to use the predeceasing spouse's exemption will typically produce better results, in some cases by truly significant amounts.
- ***Benefits Of A Simplified Single-Trust Estate Plan For Married Couples.*** Married couples can, and may prefer to, create a simplified plan that gives the entire estate to a single trust for the surviving spouse that can be subdivided after the first spouse's death by the surviving spouse or the executor to achieve the best overall result in terms of tax savings and practical considerations, based on the situation at the time.
- ***Increased Gift Tax Exemption For 2011–2012 May Have An Estate Tax Cost.*** Potential donors using the increased gift tax exemption for 2011 and 2012 should be aware that doing so may result in estate taxes later and plan accordingly. Nevertheless, using the increased gift tax exemption in 2011 and 2012 will generally be preferable to holding the assets until death.
- ***Creating "His and Her" Trusts To Use Gift Tax Exemption, Retain Access.*** Moderately wealthy couples who feel the need to retain funds to live on could still use the increased gift tax exemptions in 2011 and 2012 to create trusts for each other, retaining some access to the funds if needed.
- ***Planning Opportunities Continue For Estates Of 2010 Decedents.*** The Act extends the filing dates for estate tax returns for 2010 decedents, as well as the due dates for disclaimers, until September 17, 2011. Planning opportunities for those estates are still available, up to and including opting out of the estate tax entirely.
- ***State Death Taxes Require Attention; Illinois Reinstates Estate Tax.*** The Act increases the federal estate tax exemption, but most states that levy estate taxes are also hungry for revenue, meaning that they may not increase their exemptions to match the federal exemption. Illinois has reinstated its estate tax with only a \$2,000,000 exemption.

## Summary Of Changes To Transfer Tax Rules And Exemptions, 2010 Tax Act

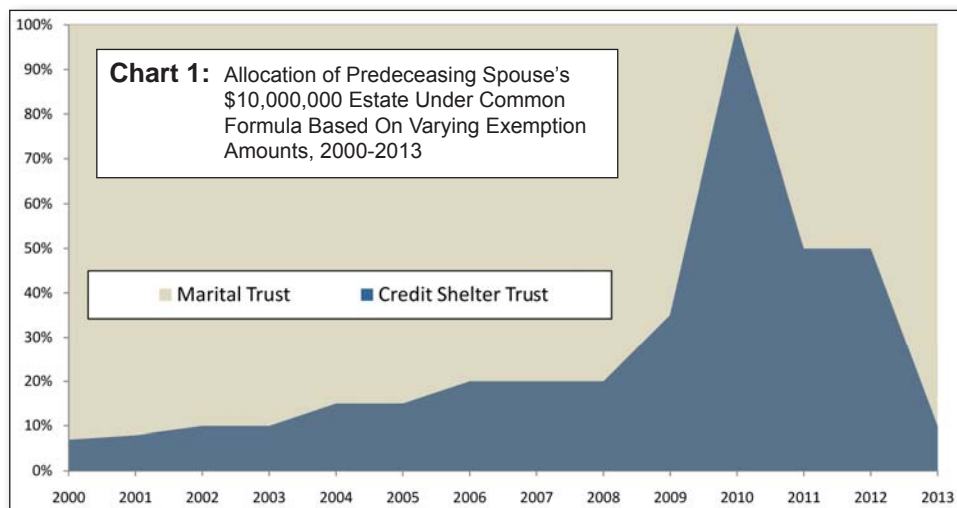
Tax:	2009		2010			2011–2012		2013 (if no action)		
	Exemption	Rate	Exemption		Rate	Exemption	Rate	Exemption		Top Rate
Gift	\$1,000,000	45%	\$1,000,000		35%	\$5,000,000	35%	\$1,000,000		55%
Estate	\$3,500,000	45%	\$5,000,000	[1]	35%	\$5,000,000	35%	\$1,000,000		55%
GST	\$3,500,000	45%	\$5,000,000		0%	\$5,000,000	35%	\$1,400,000	[2]	55%

**Notes:** [1] Executors for decedents dying in 2010 may opt out of estate tax and into carryover basis.

[2] The GST exemption shown for 2013 is a projection, as it would be \$1,000,000 indexed for inflation.

### Impact Of Tax Act On Married Couples' Estate Plans

Many married couples have estate plans designed around a formula that gives the estate tax exempt amount to one trust (or a group of beneficiaries) and the balance of the estate to the surviving spouse. The increase of the estate tax exemption to \$5,000,000 may upset the balance between the two parts of the estate, and may produce results out of line with expectations. This is especially true for plans that give all or a substantial part of the exempt amount to children, or to a trust that does not include the surviving spouse as a beneficiary. Existing estate plans should be reviewed and possibly adjusted to reduce the impact of the wild fluctuations in the estate tax exemption, such as those illustrated in **Chart 1**.



### Portability Of Estate Tax Exemption Between Spouses, While Helpful, Is Rarely The Best Solution

The Act includes new rules allowing a predeceasing spouse to transfer any unused gift and estate tax exemption to the surviving spouse, an option referred to as "portability." An election is necessary to transfer the predeceasing spouse's exemption and will require an estate tax return. Executors of estates that otherwise would not need to file a return will have to decide whether the value of the potential benefit is worth the cost of filing the return. The Act's language is ambiguous as to whether the predeceasing spouse's exemption or the survivor's own exemption is used first, but the Act's legislative history suggests that the predeceasing spouse's exemption is used first; that will generally help, and it should make remarriage decisions less complicated. Portability will reduce the likelihood of wasting the predeceasing spouse's exemption. However, more traditional planning using a credit shelter or "bypass" trust to use the predeceasing spouse's exemption will typically produce better results, in some cases by truly significant amounts (see **Chart 2**). Furthermore, traditional credit shelter trust planning will not depend on the new

portability provisions that (for now) last only for 2011 and 2012, and would not necessarily require the filing of an estate tax return.

Chart 2: Comparison Of Marital Plans	Type Of Plan		
	All-to-Spouse, Relying On Portability to Preserve Exemption	Single Fund Trust Subdivided By Tax Characteristics	Traditional Plan: Credit Shelter or "Bypass" Trust, Marital Trust
Makes Full Use Of Predeceasing Spouse's Estate Tax Exemption, <i>If</i> Portability Remains Law	✓	✓	✓
Makes Full Use Of Predeceasing Spouse's Estate Tax Exemption, <i>If</i> Portability Lapses And Is Not Renewed Or Extended	✗	✓	✓
Makes Full Use Of Predeceasing Spouse's GST Tax Exemption	✗	✓	✓
Shelters Future Growth Of Exempt Share From Estate Tax In Surviving Spouse's Estate	✗	✓	✓
Avoids Unneeded Income Distributions To Surviving Spouse, Shelters Undistributed Income	✗	✗	With Disclaimer*
			✓
Allows Direct Distributions To Descendants From Exempt Share (Or Gifts By Spouse)	✓	✗	✓
Protects Trust Assets From Creditors Of Surviving Spouse	✗	✓	✓
Provides Flexibility And Control For Spouse**	✓+	✓-	✓-
Protects Children Of First Marriage	✗	✓	✓
Makes Full Use Of Predeceasing Spouse's Illinois Estate Tax Exemption (Not Portable)	✗	✓	✓
<p>* If the surviving spouse disclaims part of the single fund trust, the disclaimed property can pass to the credit shelter or "bypass" trust and accomplish the objectives in the same manner as the traditional plan.</p> <p>** Leaving the entire estate to the surviving spouse maximizes the surviving spouse's flexibility and control. Leaving it in trusts—even trusts with the surviving spouse as primary beneficiary and serving as a co-trustee (or being able to remove and replace trustees)—will limit that flexibility and control, at least to some degree.</p>			

### **Benefits Of A Simplified Single-Trust Estate Plan For Married Couples**

It is possible to create a simplified plan based around a single trust for the surviving spouse that can be subdivided by the surviving spouse or the executor after the first spouse's death. The plan for subdivision would be able to take into account the available exemptions for federal and state estate taxes and the GST

tax, as well as other circumstances known at the time of the first spouse's death that may not be known or anticipated when the trust was created. This simple and flexible plan offers advantages in an environment where the exemption amounts are subject to unpredictable changes. The advantages of this type of plan were discussed in detail in our Spring 2003 *Special Report – Estate Planning in Uncertain Times: What You Should Be Doing Now*.

### ***Bait And Switch? Increased Gift Tax Exemption For 2011–2012 May Have An Estate Tax Cost***

The Act increases the gift **and** estate tax exemptions to \$5,000,000, but only for 2011 and 2012. Taxpayers who have not used any of their gift tax exemptions could give away \$5,000,000 (\$10,000,000 for most married couples) in 2011 or 2012 without paying gift taxes. Even those taxpayers who have used their full pre-2011 gift tax exemption of \$1,000,000 can give another \$4,000,000 (\$8,000,000 for most married couples) in 2011 or 2012 without paying gift taxes. However, the prior gift taxes paid and exemption used by the donor may not be taken into account in the way one might expect if Congress, through inaction (by allowing the Act's provisions to sunset after 2012) or action (by passing specific new legislation), reduces the exemption in effect at the donor's death. Consequently, those gifts might result in additional estate taxes at the donor's death. Donors should be aware of this potential outcome and plan accordingly, including planning for estate tax liquidity and the apportionment of the tax burden among heirs.

### ***Take The Bait! Even With An Estate Tax Cost, Using The Increased Gift Tax Exemption May Be The Smart Play***

Even if the Act sunsets after 2012 and the estate tax exemption returns to \$1,000,000, donors who can afford to make a gift of the full \$5,000,000 gift tax exemption amount in 2011 or 2012 will typically reduce the total tax burden of wealth transfers. The advantages of making gifts in 2011 or 2012 can come from valuation advantages, shifting growth outside of the taxable estate, leverage, and the grantor trust income tax rules. High net worth families should make use of this opportunity; very high net worth families could leverage it for even more benefits.

### ***Creating “His And Hers” Trusts To Use Gift Tax Exemption, Retain Access***

Moderately wealthy couples who still need funds to live on could still use the increased gift tax exemptions in 2011 and 2012 to create trusts for each other, with the caveat that the trusts must have substantial differences to prevent the trusts from being unwound and included in each donor's estate as if the gift had not been made.

### ***Planning Opportunities Continue For Estates Of 2010 Decedents***

The Act extends the filing dates for estate tax returns for 2010 decedents, along with the due dates for disclaimers from those 2010 decedents' estates, until September 17, 2011. Planning opportunities for those estates are still available, up to and including opting out of the estate tax entirely.

### ***State Death Taxes Require Attention; Illinois Reinstates Its Estate Tax***

The Act increases the federal estate tax exemption, but most states that levy estate taxes are also hungry for revenue, meaning that they may not increase their exemptions to match the federal exemption. The amount of state estate taxes on an estate that is exempt from federal estate taxes may be substantial. For example, as part of a January 2011 tax and budget compromise, Illinois reinstated its estate tax effective January 1, 2011 with an exemption of only \$2,000,000.

## Time For Action

A few of the opportunities described in this Bulletin have an absolute expiration date: **September 17, 2011**. Others may expire as soon as December 31, 2012. Your advisors in the Estate Planning Group at Vedder Price P.C. can identify the opportunities that are most relevant to your situation and help you implement strategies to take advantage of those opportunities while they remain available. Contacting us soon will help us identify the actual and practical deadlines involved.

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For questions about estate planning opportunities created by the current economic environment, please contact any member of the estate planning group.

### About Vedder Price

Vedder Price P.C. is a national business-oriented law firm composed of more than 260 attorneys in Chicago, New York City and Washington, D.C.

### The Estate Planning Group

Vedder Price P.C. has long recognized the importance of estate planning and has been at the forefront of this ever-changing area of the law. The firm's practice has both a national and an international scope. Vedder Price attorneys combine technical experience in all aspects of estate and financial planning with a strong appreciation of personal objectives and concerns in servicing clients in this uniquely personal area.

The firm represents clients with diverse personal objectives and financial interests, including individuals with large estates, individuals with personal situations requiring special planning, owners of closely held businesses, corporate executives and professionals. Vedder Price estate planning attorneys also represent executors, administrators, trustees and guardians. In addition, the firm provides estate and financial planning counsel to businesses and not-for-profit organizations, as well as other professionals who consult Vedder Price with respect to their own clients.

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