Estate Tax Relief - It's Finally Here
(at least for two more years)

Presentation Outline

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January 2011

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ESTATE TAX RELIEF - IT'S FINALLY HERE!

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The (Temporary) Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Act")

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I. Summary of Estate, Gift & Generation-Skipping Transfer (GST) Tax Exemptions, Rates & Effective Dates

Effective Date	Estate Tax Exemption / Rate	Gift Tax Exemption / Rate	GST Exemption / Rate
1/1/2010*	$5,000,000 / 35%	$1,000,000 / 35%	$5,000,000 / 0%
1/1/2011	$5,000,000 / 35%	$5,000,000 / 35%	$5,000,000 / 35%
1/1/2012	$5,000,000 indexed for inflation since 2010 / 35%	$5,000,000 indexed for inflation since 2010 / 35%	$5,000,000 indexed for inflation since 2010 / 35%
1/1/2013	$1,000,000 / 55%	$1,000,000 / 55%	$1,000,000 indexed for inflation since 2001 / 55%

* Subject to election to be exempt from estate tax with modified carryover basis for income tax purposes.

A. 2010 Estate, Gift and GST Tax Exemptions

1. Estate and GST tax exemption amounts apply retroactively to January 1, 2010.

2. Estate and GST tax exemptions are each $5 million; the gift tax exemption is $1 million.

3. Estate and gift tax rate is 35%.

4. GST tax rate is zero percent (0%) for all generation-skipping transfers (i.e., direct skips, taxable distributions and taxable terminations) occurring in 2010, whether by gift or as a result of the death of a testator. See Section III below.

B. 2011 and 2012 Estate, Gift and GST Tax Exemptions

1. Applies January 1, 2011 through December 31, 2012 (unless extended by subsequent legislation).

2. Estate, gift and GST tax exemptions are each $5 million. The estate and gift tax exemptions have been reunified (as was the case prior to 2001).

   i. Therefore, an individual can use up his or her entire $5 million exemption through lifetime gifts and be subject to estate tax on all assets owned at death because the estate tax exemption is reduced by the gift tax exemption used during life (reunified).

   ii. Prior to 2010, individuals could only gift up to $1 million during life without incurring gift tax, notwithstanding that the estate tax exemption may have exceeded such amount. For example, in 2009, an individual could only gift up to $1 million even though the estate tax exemption was $3.5 million. Under 2009 law, the $2.5 million of extra exemption was not available until death.

   iii. Beginning in 2012, the $5 million estate, gift and GST tax exemptions are indexed for inflation. The exemptions will be adjusted for cost of living dating back to 2010.

3. Estate, Gift and GST tax rate is effectively a flat rate of 35%

II. **<u>Gift and GST Planning Issues & Opportunities</u>**

A. Everyone gets the benefit of the increase in the gift tax exemption regardless of prior taxable gifts.

1. An individual who made $900,000 in taxable gifts prior to 2011 can make an additional $4.1 million of taxable gifts in 2011 or 2012 without incurring gift tax.

2. An individual who has made taxable gifts in excess of $1 million prior to 2011 (and paid gift tax on the gifts) receives an additional $4 million of available gift tax exemption. It was initially thought that this was not the case, but commentators now agree on this point.

B. Potential tax effect of using $5 million gift tax exemption on decedents dying after 2012 if estate tax exemption is reduced.

1. There is a possibility that exemptions in 2013 and beyond will be lower than those available in 2011 and 2012. Accordingly, if an individual makes $5 million of taxable gifts in 2011 which are covered entirely by the $5 million gift tax exemption and then dies in 2013 when the estate tax exemption reverts back to $1 million, it is possible that estate tax will be owed on the excess gifts because prior taxable gifts are included in the calculation of estate tax of a decedent. The answer is currently unclear. It depends on how one interprets the language contained in IRC § 2001(b)(2) and the references on Form 706 as to the "total gift tax paid or payable on post-1976 gifts."

Example: Client dies in 2013 with a taxable estate of $10 million. Client made $2 million of taxable gifts in 2009 and $4 million of taxable gifts in 2011. What is the estate tax due if the exemption has reverted to $1 million at the time of client's death in 2013?

There are at least 2 options:

Option 1 - Total gift tax paid or payable is calculated using exemption in effect at time of gift.

Note: References below are to Form 706

Line	Item	Amount
3c	Taxable estate	$10,000,000
4	Adjusted taxable gifts	$6,000,000
5	Total of lines 3 and 4	$16,000,000
6	Tentative Tax on line 5	$8,740,800
7	Total gift tax paid or payable on post-1976 gifts	<$435,000>*
8	Gross Estate Tax	$8,305,800
11	Allowable Unified Credit	<$345,800>
16.	Tax Due	**$7,960,000**

Option 2 - Total gift tax paid or payable is calculated using exemption in effect at time of death.

Note: References below are to Form 706

Line	Item	Amount
3c	Taxable estate	$10,000,000
4	Adjusted taxable gifts	$6,000,000
5	Total of lines 3 and 4	$16,000,000
6	Tentative Tax on line 5	$8,740,800
7	Total gift tax paid or payable on post-1976 gifts	<$2,595,000>*
8	Gross Estate Tax	$6,145,800
11	Allowable Unified Credit	<$345,800>
16.	Tax Due	**$5,800,000**

If no lifetime gifts had been made, the estate tax liability on a $16,000,000 estate using the 2013 rate would be **$8,395,000**.

2. The potential for a clawback or recapture tax upon death raises additional questions:

   i. Who will bear the estate tax due upon the decedent's death?

   ii. From what assets will the tax be paid?

   iii. Will there be enough assets to pay the estate tax?

   iv. Will this result in the marital deduction gift bearing tax, which causes an interrelated calculation that reduces the marital deduction and increases estate tax?

3. Planners must take these issues into account when considering gifts in 2011 and 2012.

4. Potential for recapture only applies if exemptions are reduced from 2011 and 2012 levels. Appreciation and income on assets gifted during life will still be outside of the decedent's estate at death, so unless assets gifted depreciate in value, there would not be more total tax due than if the gift had not been made.

C. Gifts made in 2011 and 2012.

The increase in the gift and GST tax exemption levels to $5 million provides numerous planning opportunities for individuals in 2011 and 2012, such as:

1. Gifts to grantor trusts.

   i. Donors are liable for the income tax on assets owned by grantor trusts, which allows such assets to grow income tax free to the trust beneficiaries. The payment of such income tax is not treated as an additional gift. Rev. Rul. 2004-64.

ii. Making large gifts to grantor trusts and having the donor pay the income tax generated by such assets can move a large amount of value, including the income and appreciation of the assets, out of the donor's estate over time.

iii. By allocating GST tax exemption to the gift, the assets will avoid transfer tax for many generations to come.

iv. This planning is not new, but with the increased gift and GST tax exemption, individuals who had already utilized their entire gift tax exemption can now do more planning.

2. Sale to grantor trust.

i. In the past, a significant barrier to making a large sale to a grantor trust was that an adequate "seed" gift must be made to the grantor trust so that it will have sufficient equity to purchase the assets. It is generally believed that a seed gift of 10% of the value of the assets to be sold to the grantor trust would be adequate. With the increased gift tax exemption, it is now possible to make a "seed" gift of up to $5 million ($10 million for a married couple electing split-gift treatment). This would allow for a sale of assets to the grantor trust totaling $50 million ($100 million for a married couple electing split-gift treatment).

ii. GST tax exemption can be allocated to the seed gift made to the grantor trust to make the gift and the assets purchased with the gift exempt from GST tax for many generations.

iii. Sale of assets by the grantor to a grantor trust will be disregarded for income tax purposes. Rev. Rul. 85-13.

iv. Both sales and gifts to trust freeze the value of the asset transferred so that the appreciation on the asset escapes tax.

3. Irrevocable Insurance Trusts

i. With the increase in gift and GST tax exemption, the payment of insurance premiums by the ILIT may no longer be limited by the availability of Crummey annual exclusion gifts and may avoid complicated other arrangements to avoid gift tax, such as split dollar agreements.

ii. Individuals with existing ILITs should consider making a large transfer to the ILIT to cover future premiums if the exemption is reduced in 2013 or to perhaps fund additional insurance.

4. Leveraging through valuation discounts

i. The 2010 Tax Act does not limit valuation discounts.

ii. If valuation discounts are applicable to the gifted or sold property (e.g., LLC, LP or stock interests), substantially more than $5 million may be able to be transferred to beneficiaries by each donor.

5. GRATs

i. Still a good planning technique, especially given the current low rates.

ii. The 2010 Act did not change the rules for GRATs, such as requiring a minimum term as has been previously proposed.

III. **<u>GST Transfers in 2010</u>**

A. Chapter 13 of the Code applies to generation-skipping transfers made in 2010. However, the tax impact of such retroactivity is mitigated because the GST tax rate is zero percent (0%) for all generation-skipping transfers (i.e., direct skips, taxable distributions and taxable terminations) <u>occurring</u> in 2010, whether by gift or as a result of the death of a testator.

1. Direct skip means a transfer to a person who is two or more generations below the generation assigned to the transferor (e.g., transfer to a trust solely for the benefit of, or outright transfers to, grandchildren).

i. For a direct skip, the event which triggers the application of the GST tax occurs at the moment the transfer is made or deemed to be made. Therefore, a direct skip transfer made in 2010 (either from a donor or pursuant to the terms of a will or trust of an individual who dies in 2010) qualifies for the zero percent GST tax rate and the transferor does not need to allocate GST tax exemption to such transfer.

2. Taxable distribution means any distribution from a trust to a person who is two or more generations below the generation assigned to the transferor (e.g., distribution from a GST non-exempt trust to a grandchild of settlor).

i. For a taxable distribution, the event which triggers the application of the GST tax occurs at the moment the distribution is made. For example, assume parent makes a transfer in 2010 to a trust which is for the benefit of children and grandchildren, and that a distribution is made to grandchild from the trust in 2011. The event which triggers the GST tax is the distribution in 2011, not the initial transfer in 2010. Accordingly, the distribution in 2011 would not qualify for the zero percent GST rate because the generation-skipping event does not occur in 2010. This applies regardless of whether the initial transfer to the trust in 2010 was the result of a lifetime gift or a transfer at death.

ii. To avoid GST tax on the distribution in 2011, the transferor should allocate GST tax exemption at the time the initial gift is made in 2010.

iii. Alternatively, assume parent created a trust in 2006 for the benefit of children and grandchildren and the parent did not allocate any GST tax exemption to such transfer. A distribution made from the trust to a grandchild (taxable distribution) in 2010 would be the event which triggers the application of the GST tax and such distribution would be subject to the zero percent GST tax rate.

3. Taxable termination means the termination of an interest in property held in a trust unless (i) immediately after such termination, a non-skip person has an interest in such property, or (ii) at no time after such termination may a distribution be made from such trust to a skip person (e.g., Settlor creates a trust for the sole benefit of child A, but upon A's death, the remaining trust property is transferred outright to grandchild B).

i. For a taxable termination, the event which triggers the application of the GST tax is the moment of termination of all interests held by non-skip persons. For example, assume parent establishes a trust in 2010 for the benefit of child A, with a remainder interest to grandchild B. Upon child A's death in 2012, the trust terminates and pays out to grandchild B. The event which triggers the application of the GST tax is A's death in 2012. Accordingly, the distribution in 2012 would not qualify for the zero percent GST tax rate because the GST transfer did not occur in 2010.

ii. To avoid GST tax on the distribution in 2012 upon A's death, the transferor should allocate GST tax exemption at the time of the initial contribution to the trust in 2010.

iii. Alternatively, assume parent created a trust in 2006 for the benefit of A and B and the parent did not allocate any GST tax exemption to such transfer. Upon A's death in 2010, the trust terminates and pays out to B. The termination in 2010 would be the event that triggers the application of the GST tax and such distribution would be subject to the zero percent GST tax rate.

B. Prior to the 2010 Act, it was unclear whether distributions in subsequent years from a direct-skip trust funded in 2010 would be subject to GST tax as taxable distributions or a taxable termination. However, the general application of Chapter 13 in 2010 as provided for by the 2010 Act means the "generation move-down rule" of IRC § 2653(a) applies. Accordingly, transfers made in 2010 to direct-skip trusts for the benefit of grandchildren do not incur GST tax because the rate for such transfers in 2010 is zero, <u>and</u> distributions after 2010 from such trusts will not be subject to GST tax because the "generation move-down rule" applies to treat the direct-skip trust as if "the transferor of such property were assigned to the first generation above the highest generation of any person who has an interest in such trust immediately after the transfer." In other words, if a gift is made in 2010 to a trust for the sole benefit of grandchildren, then distributions in 2011 or later from the trust to grandchildren are not subject to GST tax. However, if a gift is made in 2010 to a trust for the benefit of grandchildren and great-grandchildren, then distributions in 2011 or later which are made to great-grandchildren will be subject to GST tax because the generation move-down rule would assign the transferor to one generation above the grandchildren.

C. Allocation of GST Tax Exemption

1. To avoid wasting GST tax exemption for lifetime gifts, be sure to elect out of the automatic allocation rules of IRC § 2632 for any direct-skip transfer which occurs in 2010 since the transfer would be subject to the zero percent GST tax rate, such as outright transfers to grandchildren or more remote generations, or transfers to a trust which is for the sole benefit of grandchildren. The GST tax exemption should be allocated instead to indirect skip transfers (i.e., a transfer to a trust which could have a generation-skipping transfer at some point in the future, such as a transfer to a trust for the benefit of children and grandchildren) occurring in 2010 so that distributions in subsequent years resulting from the indirect skip transfer are exempt from GST tax.

2. To avoid wasting GST tax exemption for transfers arising from a decedent's death in 2010, be sure to affirmatively allocate the decedent's GST tax exemption to indirect skip transfers (and away from direct skip transfers) for which the event triggering the application of the GST tax will occur in subsequent years when distributions are made or the trust terminates.

D. Consider using qualified disclaimers to take advantage of zero percent rate for generation-skipping transfers occurring in 2010.

1. Disclaimers which are qualified for federal tax purposes are effective retroactively to the date of the decedent's death. Therefore, a generation-skipping transfer which is the result of a timely disclaimer in 2011 should be deemed to be "made" in 2010.

i. For example, assume that the will of a decedent dying in 2010 provides that $100 shall be distributed to child, but if child predeceases, then such $100 shall be distributed to grandchild. If child executes a qualified disclaimer, then the transfer to grandchild will be a direct-skip from decedent subject to the zero percent GST tax rate and no GST tax exemption should be allocated to it.

2. A qualified disclaimer cannot be made if the beneficiary has accepted any of the benefits from his or her bequest. Accordingly, if there is any potential for a disclaimer, special care must be taken to ensure that such beneficiary does not undertake any action with respect to the property which may constitute acceptance.

3. Make sure disclaimer also satisfies state law requirements.

4. See rules for extension of time to make a disclaimer in Section VII below.

IV. **Decedents Dying in 2010**

A. General Rules: Estate and GST tax are reinstated retroactively to decedents dying on or after January 1, 2010.

1. Estate tax exemption is $5 million and estate tax rate is 35%.

2. GST tax exemption is $5 million. The applicable rate for generation-skipping transfers made in 2010 is zero.

3. Basis rules of IRC § 1014 apply. Thus, property acquired from a decedent generally receives a basis in the hands of the beneficiaries equal to the fair market value on the date of the decedent's death (or alternate valuation date if applicable). This may result in a stepped up basis or stepped down basis.

B. Election: Personal representative/executor (PR) of decedent dying in 2010 (either before or after enactment) has the option to elect out of the estate tax and into the modified carryover basis rules of IRC § 1022 which applied in 2010 prior to the 2010 Act.

1. Refresher on IRC § 1022 carryover basis rules

i. General rule: Basis is lesser of carryover basis or fair market value at death. Thus, could get a step down in basis.

ii. Special Basis Adjustment: PR can allocate up to $1.3 million (increased by § 1212(b) capital loss carryovers, § 172 net operating losses and § 165 losses) to increase the basis of assets owned by and acquired from the decedent, but the basis of an asset may not be increased beyond fair market value at date of death.

iii. Spousal Basis Adjustment: PR can allocate up to $3 million to increase the basis of "qualified spousal property" (i.e., property received by spouse outright or qualified terminable interest property) acquired from the decedent, but not beyond fair market value at date of death.

iv. Existing QTIPs and property includible by general power of appointment (GPOA) appear to be excluded from property to which basis adjustment may be allocated because a decedent holding a qualifying income interest in a QTIP or a GPOA will not be treated as the "owner" of such property.

v. No automatic long term holding period for property acquired from a decedent.

2. For decedents with $5 million or less, it will generally be more beneficial to apply the default estate tax rules. For large estates, it will generally be more beneficial to elect out of the estate tax and into carryover basis. However, the PR must run the numbers and consider the potential impact of IRS adjustments to lifetime gifts and hard-to-value assets. The question becomes whether to pay estate tax now and receive a stepped up basis for assets, or elect out of estate tax and only receive a partial step up in basis.

3. Procedure for making the election is not yet established.

4. Numerous factors for a fiduciary to consider when making the election, including:

i. Basis of each asset;

ii. Date of death value of each asset;

iii. Projected value and earnings of each asset;

iv. Tax character of gains, earnings and losses;

v. Projected holding period of each asset;

vi. Present value of future income tax vs. current payment of estate tax;

vii. Identity of beneficiaries (any charities?);

viii. Ability to allocate special ($1.3 million) or spousal ($3 million) basis increases to assets;

ix. Impact of election on formula clauses in testamentary instrument;

x. Estate tax apportionment among beneficiaries;

xi. Potential for disagreement among beneficiaries in allocating special and spousal basis increases;

xii. Future income and estate tax rates;

xiii. Domicile of beneficiaries and personal income tax information; and

xiv. Impact of state estate tax, if applicable.

5. Potential for disagreements among beneficiaries can substantially complicate decision on whether to make election.

i. A fiduciary should seek court approval of the election or obtain consents from beneficiaries whenever possible.

ii. A fiduciary who is also a beneficiary whose share will be affected by whether or not the election is made must be cognizant of such conflict of interest. Consider appointing an independent fiduciary to make the decision or seeking court approval.

iii. A breach of fiduciary duty can lead to personal liability. Therefore, a fiduciary should strictly adhere to fiduciary duties and document his or her diligence in analyzing whether to make the election out of the estate tax. Beneficiaries should remain informed and consulted, to the extent practical.

6. Florida enacted §§ 733.1051 and 736.04114, which allows a fiduciary or beneficiary to petition a court to ascertain the testator's or settlor's intention when the governing instrument contains a formula division of property which is ambiguous under 2010 law. One cannot assume that merely because the estate tax was reinstated as the general rule for 2010 that such a formula clause is no longer ambiguous. The election out may be enough to create the ambiguity.

C. Regardless of whether the election out of the estate tax is made, the GST rules of Chapter 13 of the Code still apply.

V. **<u>Decedents Dying in 2011 and 2012</u>**

A. General rule is that estate and GST tax apply as they did in 2009, with some changes. The election out of estate tax and into carryover basis is <u>not</u> available after 2010.

1. Estate and GST tax exemptions are each $5 million, but beginning in 2012, such exemptions are indexed for inflation since 2010.

2. Estate and GST tax rate is 35%.

B. Estate tax exemption is reunified with gift tax exemption. Therefore, entire $5 million estate tax exemption may be used prior to death.

C. Estate tax exemption is portable between spouses (see Section V below for detailed discussion). GST tax exemption is not portable.

D. IRC § 1014 basis rules apply, which result in assets acquired from a decedent receiving a basis in the hands of the beneficiaries equal to their fair market value on date of death or the alternate valuation date if applicable (step up or step down).

E. Formula clauses in wills and trusts need to be reviewed.

1. The higher exemption amount may result in more property than intended passing to one set of beneficiaries and not enough passing to another. For example, if a decedent has a $5 million estate and the formula provides for the maximum amount that can pass free of federal estate tax by reason of the unified credit to pass to a credit shelter trust, of which the spouse is not a beneficiary, then the spouse may not receive any property under 2011 and 2012 law. Under the law in 2009, the spouse would have received at least $1.5 million under the same formula. Alternatively, if a will provided for the maximum GST tax exemption to go to grandchildren in trust with the rest to children, the increased exemption could result in unintended consequences.

F. State estate tax planning still an issue. Currently, 14 states have separate estate taxes and exemptions that are lower than $5 million.

VI. **Portability**

A. "Portability" means that the personal representative of a deceased spouse's estate may transfer any unused estate tax exemption to the surviving spouse.

B. Portability is intended to provide a married couple the opportunity to utilize the exemptions of both spouses even if the couple failed to plan prior to the death of the first spouse. For example, assume H has $10 million of assets in 2011 and W has $0. Without portability, if W died in 2011 (without any assets), W's $5 million exemption would be lost. When H dies in 2012, estate tax would be due on the $5 million of assets in excess of H's $5 million estate tax exemption. With portability, no estate tax would be due upon H's death because H could add W's unused $5 million exemption to H's exemption, thus giving H a total exemption of $10 million.

C. Portability applies to decedents who die in 2011 or 2012.

1. Both spouses would have to die in 2011 or 2012 for portability to be useful (unless the portability provisions are later extended by Congress).

D. Procedure of election.

1. Election is made by the personal representative of the deceased spouse's estate on a timely filed estate tax return. Therefore, even small estates of married individuals need to consider whether to file an estate tax return upon the death of the first spouse because it is unknown whether the surviving spouse will later need the unused exemption of the predeceased spouse.

2. Notwithstanding the expiration of the limitations period within which the IRS may assess an estate or gift tax on a decedent, the IRS may review / adjust the portability amount shown on a deceased spouse's estate tax return at any time after the filing of such return for purposes of adjusting the deceased spousal unused exclusion amount available to the surviving spouse. Notwithstanding this unlimited period, there should be no reason for the IRS to seek an adjustment to the portability amount following after the limitations period applicable to the surviving spouse's estate tax return has expired.

3. The election is irrevocable.

E. The election applies only to the deceased spouse's unused estate and gift tax exemption.

1. Surviving spouse can use the unused exemption of the deceased spouse to make gifts during the lifetime of the surviving spouse.

2. GST tax exemption is not portable.

3. The portability amount is not indexed for inflation.

4. The surviving spouse's increase in estate tax exemption does not affect the estate tax return filing threshold for the surviving spouse. Thus, if the surviving spouse had $5 million of her own exemption and the PR of the deceased spouse elected to transfer the deceased spouse's $5 million of unused exemption to the surviving spouse, the surviving spouse would have a total of $10 million of estate tax exemption. The surviving spouse's estate would still be required to file an estate tax return if the gross estate was in excess of $5 million even though there would be $10 million of estate tax exemption available.

F. Use of deceased spouse's exemption.

1. Privity requirement.

i. Portability only applies to the most recent deceased spouse. A surviving spouse cannot stockpile unused exemptions from multiple spouses.

ii. The statutory language does not suggest that a surviving spouse can transfer to spouse 2 the unused exemption that is received from predeceased spouse 1. For example, if H1 dies with $4 million of unused exemption, which is transferred to W, and W later remarries H2, it does not appear that W's $9 million of exemption can be transferred to H2 upon W's death. Instead, if W predeceases H2, then H2 would be limited to the amount of W's $5 million which is unused at her death. Further, if H2 dies before W, then W will lose H1's unused exemption.

2. Deceased spouse's exemption used first?

i. According to an example in the Staff of the Joint Committee on Taxation report, the surviving spouse uses the deceased spouse's exemption first, either by lifetime gift or by a transfer at death. However, some commentators have questioned the accuracy of this example.

ii. A surviving spouse who is considering remarriage should consider making taxable gifts, using the deceased spouses exemption, because if the new spouse predeceases, the first spouse's unused exemption will be lost. However, this raises the same recapture concerns mentioned above in Section II.B which apply if the estate tax exemption is later reduced.

G. Portability may impact the decision of a surviving spouse to remarry, depending on the health and unused exemption of the potential new spouse.

H. Portability vs. Trust Planning

1. Portability should be thought of as a fall back position when no other planning has been done.

2. Pros for portability.

i. Easy to plan to use portability.

ii. Portability allows for assets to be devised directly to the surviving spouse, so at the surviving spouse's death, the assets get a stepped-up basis on the first spouse's death and the second spouse's death.

iii. Remedy for poor planning.

3. Cons for portability.

   i. Only applies for 2011 and 2012.

   ii. The portability amount is not indexed for inflation.

   iii. Appreciation in assets transferred to surviving spouse is included in gross estate of surviving spouse

   iv. Does not apply to GST tax exemption.

   v. Does not increase the estate tax return filing threshold.

   vi. An estate tax return must be filed in order to elect portability.

4. Pros for planning on death of 1st spouse, such as using a credit shelter trust.

   i. Appreciation in credit shelter trust escapes estate tax at the surviving spouse's death.

   ii. GST tax exemption can be allocated to a credit shelter trust and thus is not lost.

   iii. Assures that assets are transferred as predeceased spouse intended upon later death of surviving spouse. This planning will still be very important for spouses with children from prior marriages.

   iv. Provides protection from creditor and marital claims of surviving spouse.

   v. A credit shelter trust will not be included in the surviving spouse's estate even after the 2010 Act sunsets.

   vi. An estate tax return is not required to be filed if the deceased spouse's gross estate is less than the estate tax exemption amount, regardless of the value of the credit shelter trust.

   vii. Beneficial in states where there is an independent estate tax.

5. Cons for credit shelter trusts.

   i. Increased administration burden.

   ii. Assets in a credit shelter trust do not get a stepped-up basis upon the surviving spouse's death; but could possibly get the step up with the use of a Super Charged Credit Shelter Trust™!

6. Lifetime QTIP trusts also provide significant benefits over portability.

   i. Florida Statutes § 736.0505(3), which became effective July 1, 2010, presents a significant opportunity to protect large amounts of wealth. Before the enactment of this statute, it was unclear whether the donor spouse or the beneficiary spouse was treated as the settlor of any trust(s) created upon the death of the beneficiary spouse under a lifetime QTIP. The statute clarifies that the beneficiary spouse of a lifetime QTIP is treated as the settlor of any trust(s) created upon the death of the beneficiary spouse under the lifetime QTIP for the benefit of the original donor spouse. Thus, any trust(s) created under the lifetime QTIP will not be treated as a self-settled trust as to the original donor spouse and therefore, the assets of such trust(s) will not be subject to the creditors of the original donor spouse.

   ii. *Example*. Assume Doctor D has a $3 million retirement plan, $1.5 million homestead, $200,000 of accounts receivable owned by his practice, and $5,000,000 in investment assets. D is married to W, who has no assets.

   Prior to F.S. § 736.0505(3), the general options available to D to protect assets were to (i) transfer assets into W's name, or (ii) transfer assets into tenants-by-the-entireties with W. However, transferring assets into W's name makes such assets available to W's creditors. Transferring assets to tenants-by-the-entireties between D & W protected those assets from H's individual creditors and W's individual creditors, but before portability, the price was the loss of W's estate tax exemption if she died first. Further, if W died first, assets owned as tenants-by-the-entireties revert to the individual name of D and become available to the creditors of D.

   Under the 2010 Act and F.S. § 736.0505(3), D could transfer the $5 million of investment assets into a lifetime QTIP for wife. No gift tax will be due. Assets in QTIP will be shielded from wife's creditors during her lifetime. Upon wife's death, the QTIP assets are includible in her estate (assume $5 million estate tax exemption) and are transferred, under the terms of the QTIP, to a credit shelter trust for the benefit of D. The assets of the credit shelter trust are then protected from D's creditors and are not includible in D's estate.

   iii. Accordingly, lifetime QTIPs can be used to shift assets into the estate of less wealthy spouse and shield assets from claims of creditors of beneficiary spouse and donor spouse.

iv. Be careful of the reciprocal trust doctrine if each spouse creates a lifetime QTIP for the benefit of the other spouse. Additionally, planning needs to be done to cover the possibility of divorce.

VII. **Procedural Issues**

A. For decedents dying between January 1, 2010 and December 16, 2010 (the date prior to the date of enactment of the 2010 ACT), the 2010 Act extends the deadline for the following items to no earlier than 9 months after the date of enactment of the 2010 Act (September 17, 2011):

1. Filing the estate tax return and paying estate tax;

2. Filing any election required on the estate tax return;

3. Filing Form 8939 (carryover basis);

4. Disclaiming an interest in property received from a decedent;

    i. Need to be careful that the disclaimant has not received and does not receive any benefit from the disclaimed property prior to executing the disclaimer.

    ii. Note that some states (other than Florida) impose a time period for a disclaimer to be effective for state law purposes which may be less than the extension granted by the 2010 Act. Florida law does not impose any time limitations and, in fact, contains a general provision that any disclaimer which is qualified for federal tax purposes is also qualified for state law purposes.

5. Filing any return to report an inter vivos or testamentary generation-skipping transfer; and

6. Making any election on a return to report an inter vivos or testamentary generation-skipping transfer.

B. Note: 9 months from the date of enactment of the 2010 Act is Saturday, September 17, 2011. Therefore, the actual due date for the above actions (other than making a qualified disclaimer) is September 19, 2011.

C. The procedures for electing out of the estate tax and into carryover basis for 2010 decedents has yet to be issued. The most recent draft Form 8939 was issued on December 16, 2010, prior to the enactment of the 2010 Act which contains the election.

VIII. <u>**2013 and Beyond**</u>

A. The 2010 Act postponed the sunset of EGTRRA until December 31, 2012. Therefore, if Congress does not make any further changes to the law, the following exemptions and rates will become effective on January 1, 2013:

1. Estate tax exemption and gift tax exemption will revert to $1 million;

2. GST tax exemption will revert to $1 million, but will be adjusted for inflation since 1997;

3. Maximum estate tax rate will be 55%, with a 5% surtax on estates between $10 million and $17,184,000;

4. Maximum gift tax rate will be 55%; and

5. GST tax rate will be flat 55%.

B. Several key provisions will also go away on January 1, 2013 if EGTRRA sunsets without further Congressional action, including:

1. Automatic allocation of donor's GST tax exemption to lifetime transfers that are not direct skips;

2. Qualified severance of a trust into multiple trusts for GST tax purposes;

3. GST Section 9100 relief;

4. Retroactive allocations of GST tax exemption to a transfer in trust where a lineal descendant of the grandparent of the transferor or of the transferor's spouse or former spouse predeceases the transferor; and

5. Portability of estate and gift tax exemption between spouses.

C. Additionally, the 2010 Act did not resolve all of the areas of uncertainty arising from the scheduled sunset of EGTRRA. Some of these issues include:

1. What is meant by the EGTRRA sunset provision which provides that the tax laws are to be applied "as if [EGTRRA] had never been enacted"?

2. How will the sunset affect allocations of GST tax exemption which were made during EGTRRA in excess of the 2013 GST tax exemption amount? Will it be necessary to recalculate the inclusion ratio of GST trusts?

3. Are automatic allocations of GST tax exemption still effective?

4. Will qualified severances be affected?

5. Did the estate tax inclusion period (ETIP) of all trusts the transferors of which were alive on January 1, 2010 terminate on such date?

    a. The general rule is that an ETIP terminates on the earlier of (i) the first date on which the value of the property involved in such transfer would not be includible in the gross estate of the transferor for federal estate tax purposes if the transferor died, (ii) the date on which there is a generation-skipping transfer with respect to such property, and (iii) the date of death of the transferor.

    b. It is not clear whether an ETIP which should have terminated on January 1, 2010 when there was no estate tax, is reinstated by the retroactive reinstatement of the estate tax.

    c. Further, it is not clear whether the mere fact that a PR could have elected to render the estate tax inapplicable is sufficient to create a date on which the transferred property would not have been includible in the decedent's gross estate.

D. What if exemption amounts and/or tax rates are decreased after 2012? Will gifts made in 2011 and 2012 which are in excess of these lower exemptions incur estate tax?