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Estate Planning Counsel

2010 Tax Relief Act

Congress enacted a new tax act at the end of December. This is an important law in many ways which made significant changes to the Estate, Gift and Generation-Skipping Transfer (GST) tax laws. The good news is that almost all of these tax changes are favorable. The bad news is that these changes are, once again, only temporary and will expire at the end of next year (2012) unless Congress enacts additional legislation. In summary, the changes make it desirable for all clients to review their estate plans.

Overview of the new law. The 2010 Tax Relief Act provides temporary relief by reducing the Estate, Gift and GST taxes for 2011 and 2012. Also, for estates of decedents dying after December 31, 2010, a deceased spouse's unused estate, but not GST, exemptions, may be shifted to one surviving spouse. For estates of individuals dying in 2009, the top estate tax rate was 45% and there was a $3.5 million exemption. For 2011 and 2012, the 2010 Tax Relief Act reduces the top rate to 35%. The 2010 Tax Relief Act increased the Estate, Gift and GST tax exemptions to $5 million. However, under the law as written, those exemptions will drop back to $1,000,000 (somewhat higher for GST tax purposes) after 2012.

The effective rate of Estate, Gift and GST taxes can result in significant changes in what each of your heirs receives depending upon on the size of your estate. Your documents should be reviewed to ensure that they reflect your wishes no matter what the exemption amounts or the rate of tax are when your wealth passes to you heirs.

It is also appropriate for clients to consider using their increased Gift and GST tax exemptions during life. Obviously, for many people, a lifetime gift of $5 million is much too large. However, a smaller gift using a part of the larger exemption may be wise to consider. This takes careful planning in structuring the gifts.

1. Review Your Existing Plan.

After someone dies, many trust documents create a credit shelter trust. This could mean all of the first spouse's assets in an estate worth less than $5 million could end up in a credit shelter trust, and the remaining surviving spouse will not have complete discretion in using the trust assets. This may or may not be what you intended.

2. Portability Doesn't Replace Proactive Estate Planning.

The new portability provision (which introduces the concept that unused exemption in the estate of the first spouse to die is available in the estate of the second to die) may cause clients to think that proactive planning is not necessary to protect your legacy and reduce estate tax. This is not the case. Presently, the law benefits only spouses who both die by December 31, 2012. By taking steps to address your estate now, you can help ensure your wishes will be carried out for assets you place into trust. In addition, assets can be held in a credit shelter trust created at your death for the benefit of family members and has advantages not otherwise available, such as the following:

- Use of higher exemptions – Portability may not apply after 2012.
- GST planning – Portability does not apply even in 2011 and 2012 for GST taxes.
- Appreciation not taxed – The appreciation of assets held in a credit shelter trust is not taxed for estate tax purposes. Not until a credit shelter trust pays assets outright to its beneficiaries and those beneficiaries die will an estate tax be levied again on those assets. A possible disadvantage could occur when these assets, when added to the surviving spouse's estate at death, would not have generated any estate tax but also do not receive a date of death step up in basis.
- Creditor claims may not apply – Generally, assets are not subject to creditor claims of the trust beneficiaries. Divorcing spouses and other traditional creditors would not be able to access the principal of a credit shelter trust to meet their claims against the trust beneficiaries.
- Control of assets – The deceased spouse can stipulate the guidelines for trust assets instead of allowing the surviving spouse complete control of the assets.

3. Consider Taxable Lifetime Gifting.

For people who can afford to part with the assets, lifetime gifting can be an effective strategy to move assets, and consequently their appreciation and income stream, to beneficiaries. With the ability to shift $5 million, rather than $1 million, you can transfer significant assets during your lifetime. How these gifts will be taxed if your estate occurs in a later year with a lower exemption amount is not known.

4. Other Estate Reduction Strategies Remain.

Many estate reduction strategies are not affected by the new law. Items to consider when consulting with your tax and legal professionals include the following:

- Consider annual gifts during your lifetime. You may continue to make gifts up to $13,000 per person per year ($26,000 if a married couple elects to "gift split") to lower your overall estate, which reduces your potential estate taxes.
- Consider being charitable. Giving to charities during your lifetime not only can help reduce your estate taxes, but may also be an income tax deduction. If you choose to leave assets when you die to a qualified charity, you will receive a dollar-for-dollar deduction on your estate tax return for the value of those charitable bequests. The 2010 Tax Relief Act permits persons over 70 ½ to divert up to $100,000 in 2011 only from their IRA to qualified charities which meets a required minimum distribution from their IRA. At the least, this would save Indiana residents approximately 4 ½ % of the IRA transfer.

The Only Constant in Life is Change

During the last 10 years, estate and gift tax laws have been constantly changing. We believe it is important to remain diligent and proactive when working toward your long-term estate goals. The new law provides a chance to take advantage of appropriate opportunities available now. If those opportunities align with your ultimate legacy goals, consider whether you should take advantage of this two-year window. However, it is critical to be proactive in your legacy goals and to remain prepared to adjust with the law as it continues to change.

We look forward to discussing these important changes and how they can be used to enhance your estate planning. Please call to arrange for us to meet at your convenience to go over these important changes in the tax law.

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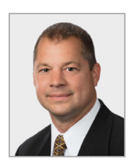

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