

Estate Planning 2012:
Teaching Old Dogs New Tricks (and Reviewing Some Old Ones)

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Most estate planning fundamentals are the same in 2012 as they were in years past. Even Federal Estate Tax and Federal Gift Tax (sometimes collectively known as “transfer tax”) rules haven’t changed much from 2011 to 2012. Nevertheless, there are quite a few “new tricks”, or at least “newer tricks”, to teach us old dogs (by the way, for the purpose of this article, you qualify as an “old dog” if you are old enough to pay taxes!). And it’s always good to review the old tricks we’ve been teaching for many years.

I think it’s helpful to outline the evolution of the new tricks, as follows: a) Estate Tax and Gift Tax rules changed dramatically in the last decade or so, and in a few remarkable ways between 2009 and 2011; b) the rules that will apply in 2013 are uncertain; c) 2012 rules provide extraordinary strategic opportunities for shifting wealth from one generation to the next; and d) the window to employ these strategies is scheduled to close at or before the end of this year.

First, I’ll briefly review some old tricks - fundamentals - that apply to nearly everyone. Many people mistakenly believe that they can ignore estate planning now because of the current rules that eliminate or minimize Estate Tax liability for a huge percentage of the population. I assure you that the current tax law, which you’ll see is in a major state of flux, is no reason to forego foundational estate planning, which remains vital for many reasons.

After reviewing fundamentals, I’ll lay out background on the recent changes in Estate Tax and Gift Tax, including: the rules that applied in the recent past; the current rules; and the transfer tax rules that are scheduled to be in place less than a year from now, in 2013. I’ll conclude by describing the key extraordinary strategic opportunities I mentioned above, and why those of considerable wealth should give serious consideration to employing one or more of the available advanced strategies before the scheduled window closing.

Fundamentals:

1) Only a portion of Estate Planning involves Estate Tax mitigation. Much more essentially, it involves setting up a logical structure and contingency plan to control your financial affairs optimally during your life; detailing in a practical manner what is to happen to your assets when you’re gone; controlling assets for minors, young adults, and special needs beneficiaries, the way you deem most appropriate; and avoiding unnecessary estate administration fees, costs, inconvenience, and delays.

2) If you do not have a comprehensive, up-to-date Estate Plan, you and your loved ones would surely benefit by establishing and/or updating the following documents: a) Revocable Living Trust; b) Will; c) Power of Attorney; and d) Advance Health Care Directive. In particular, establishing a Living Trust (instead of having just a Will) provides a lot of the above-referenced benefits and a number of other appealing advantages.

Federal Estate Tax and Gift Tax Background & Current Rules:

1) In the 1990’s, the amount that was exempt from taxation under Estate Tax law (“estate tax exemption” or “exemption”) - the amount of net assets you could own on your death

without being subject to tax - was in the \$600,000's, with a top tax rate of 55% applied to the amount exceeding the exemption.

2) In 2001, "EGTRA" tax law was enacted, under which the exemption increased periodically through 2009 from \$1 Million to \$3.5 Million, with a top tax rate of 45%.

3) The 2001 tax law "sunset" at the end of 2009, at which time Estate Tax was repealed for 2010. The law further provided that if no new legislation was enacted before the end of 2010, the exemption would go back to \$1 Million, with a top tax rate of 55%.

4) The Gift Tax system was such that (with some notable exceptions that are beyond the scope of this article) the aggregate amount you could gift during your lifetime – for example, to children – without being subject to Gift Tax was \$1 Million. By the way, the basic reason for having a Gift Tax is to ensure that you don't give all your assets away during your life, which would be an easy way to enable your inheriting loved ones to escape Estate Tax that would otherwise be due upon your death.

5) On Dec. 17, 2010, Congress finally passed sweeping tax legislation that included new Estate Tax and Gift Tax rules, increasing the exemption to \$5 Million in 2011 and \$5.12 Million in 2012 (indexing the 2011 amount for inflation), with a top tax rate of 35%.

6) A critical change for planning purposes is that the aggregate amount one can give away during life without being subject to Gift Tax increased from \$1 Million to \$5 Million!

7) Current law allows for "portability", which basically allows the surviving spouse to use any part of the exemption of the first spouse to die that the deceased spouse didn't use. The rules are complex, but this adds planning flexibility, and can be particularly helpful in cases in which one spouse's estate is much smaller or larger than the other spouse.

8) Very importantly, Federal Estate and Gift Tax rules are not static. The new Estate Tax and Gift Tax exemptions and lower tax rates apply *only through the end of 2012*, at which time the law again sunsets. The "default" (i.e. if no new legislation is enacted by Dec. 31, 2012) is that on Jan. 1, 2013, the Estate Tax exemption will drop to \$1 Million, and the applicable tax rate will be 55%; and the Gift Tax exemption will also drop to \$1 Million.

Extraordinary Strategic Planning Opportunities:

Estate Tax is not a popular tax, and the trend for decades has been to maintain or increase applicable exemptions. However, given the declination in US fiscal balances over the past decade, it is difficult to opine that this trend will continue and makes forecasting 2013 difficult.

What we know for sure is that the Gift Tax exemption is at an unprecedented level of \$5 Million (a combined \$10 Million for a married couple), but in less than a year, it's scheduled to decrease to \$1 Million. For those with larger estates, particularly those who have more than \$5 Million, the new rules have created a very attractive opportunity to shift wealth to younger loved ones, while potentially reducing or eliminating liability for Estate Tax and Generation Skipping Tax (a harsh additional tax imposed under certain circumstances when people more than one generation below you receive a gift or inheritance from you).

While we don't know what the exemption will be in the future, if you have a large estate and you can comfortably afford to make very substantial gifts to loved ones before the end of this year or

new legislation passes, whichever comes sooner, there's a compelling argument to do so. **At the current Estate Tax rate, for every \$1 Million in assets you can gift and thus remove from your taxable estate before you die, your loved ones receive the benefit of \$350,000. At the scheduled top tax rate of 55% for 2013, that savings to your loved ones would be \$550,000!** Moreover, all of the future income and appreciation of whatever amount you gift grows in the estates of your loved ones (rather than remaining in your estate and being subject to Estate Tax).

Fortunately, many strategies exist that allow you to “have your cake and eat it too” – you can make a gift, but control it the way you want. Mostly, these techniques involve establishing one or more of a number of different kinds of irrevocable trusts. Some of the more common ones are: a) Irrevocable Life Insurance Trusts; b) Defective Grantor Trusts; c) Grantor Retained Annuity Trusts; and d) Qualified Personal Residence Trusts.

These advanced planning strategies, when properly drafted and implemented, are very helpful in controlling gifts and in leveraging tax advantages that are available. Although there is no imminent danger of Congress taking away any or all of these strategies, some of them are so powerful that discussion in Washington about prohibiting or drastically limiting them has taken place over recent years. The “bottom line” is that for those with larger estates, there's no time like the present to meet with an experienced Estate Planning attorney to explore viable strategies that will likely result in lower transfer taxes and thus ultimately, more for your loved ones.

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