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For additional information on this or any trust and estate- related issue, please contact RMF's Trusts & Estates co-chairs: Michael K. Feigenbaum, who can be reached at 516-663-6540 or mfeigenbaum@rmfpc.com or Steven P. Block, who can be reached at 516-663-6571 or sblock@rmfpc.com.

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THE ESSENTIALS OF ESTATE PLANNING IN 2011

On January 1, 2011, new legislation went into effect that: (i) significantly changed the Federal estate, gift and generation-skipping transfer ("GST") tax rates, (ii) unified exemption amounts, and (iii) introduced the concept of "portability" to help avoid wasting unused exemptions. This new law sunsets on December 31, 2012 and as we experienced with the Federal estate tax repeal in 2010, there is no telling whether Congress will extend these tax provisions into 2013 and beyond. Accordingly, estate planning should be addressed now to take advantage of the opportunities brought about by new tax law changes, as well as to consider non-tax issues that remain of critical importance.

Tax Rates

In 2011, the maximum estate, gift and GST tax rates decrease from 45% to 35% and the "step-up" basis rules for inherited property remains intact. This lower rate will apply for 2011 and 2012, as well as for 2010 through the retroactive reinstatement of the Federal estate tax. Fiduciaries for decedents dying in 2010 can elect to "opt out" of the estate tax, but the tradeoff is that the estate's assets will be subject to the modified carry-over basis rules.

Exemption Amounts

The new law reunifies the estate, gift and GST exemption amounts to $5,000,000, subject to adjustments for inflation for those years beyond 2011. This change increases the gift tax exemption amount by $4,000,000 (from the previous exemption amount of $1,000,000), significantly expanding one's ability to make lifetime transfers without incurring a gift tax. Spouses can now transfer a total of $10,000,000 either during their lifetime, or at their death, free of estate, gift and GST tax. Additionally, the gift tax annual exclusion continues in 2011 and 2012 at $13,000 (or $26,000 if spouses elect to split gifts) for those who wish to continue utilizing annual tax-free gifting opportunities.

These increased exemption amounts necessitate a review of one's estate planning objectives to determine if the newly available gift exemption amount should be utilized toward additional estate planning techniques before 2013. For example, those who resisted incurring a gift tax by limiting their lifetime gifting to $1,000,000 should revisit their gifting strategies to potentially transfer another $4,000,000 gift and GST tax-free.

Portability

To help assist taxpayers in utilizing each spouse's gift and estate tax exemption amounts, the new law has introduced a concept referred to as "portability." Under the old law, if an individual dies without utilizing all of his/her gift and estate tax exemption amount, that unused portion was lost. Conversely, under the new law, a surviving spouse may use the unused exemption of his/her deceased spouse who dies after 2010. For example, if Spouse-A dies in 2011 using only $1,500,000 of his/her exemption amount because the bulk of the assets were in Spouse-B's name, then Spouse-B will have his/her $5,000,000 exemption amount plus Spouse-A's $3,500,000 unused exemption amount for a total of $8,500,000.

While portability provides a degree of flexibility that was previously absent, one should rely on this concept with caution for the following reasons. Portability must be affirmatively elected on the estate tax return by the fiduciary of the first spouse to die. This can be problematic because the first spouse's estate may not be required to file an estate tax return thereby missing the required election. Next, by relying solely on portability and failing to balance each spouse's estate prior to the first death, the main advantages to placing assets in a bypass trust are lost. These advantages include creditor protection and the ability to avoid estate tax on appreciation related to those assets during the period between each spouse’s death. Finally, the GST exemption and the New York estate tax exemption (currently $1,000,000) are not portable.

Given these important shortcomings, it is recommended that portability be a plan of “last resort” and not an alternative to structuring estate plans in which both spouses fully utilize their exemptions.

Non-Tax Issues

In addition to the tax law changes discussed above, there remain important non-tax issues, which need to be addressed through the estate planning process.

First, the steady growth of retirement assets and life insurance policies require the coordination of beneficiary designations with other estate planning documents to ensure distribution objectives and estate tax burdens are consistent with one's intent.

Second, utilizing trusts as a planning technique to provide asset protection benefits may be beneficial at all levels of wealth, given our ever expanding litigious society. When properly drafted, trusts can: (i) provide a high level of beneficial enjoyment that is flexible and accessible, (ii) shield assets from a beneficiary's creditors, equitable distribution in the event of a divorce and the elective share upon a beneficiary's death, and (iii) effectively keep trust assets from a beneficiary's taxable estate.

Third, ancillary planning documents such as a Power of Attorney (“POA”), Health Care Proxy and Living Will must be in place to manage lifetime decisions. A relatively new issue has been the transformation of the POA from a straightforward statutory “short” form to an increasingly complex set of documents requiring the specific skill of an attorney for its preparation.

Accordingly, to ensure that estate planning objectives and health care decisions can be effectively carried out while living, these documents should be prepared as part of the estate planning process.

Conclusion

In light of the very substantial tax law changes and the importance of non-tax issues, it is critical that clients and their advisors review existing estate plans and re-assess current planning initiatives. If we can be of any assistance on this or any other estate planning issues, please do not hesitate to contact us.