

SuttleLaw, P.C.

**The Future of Estate Tax:
Planning During Transitional Years**

Presented By:
John C. Suttle

December 5, 2009

Estate Tax

- **Current Law**
 - Lifetime Exemption = \$3,500,000
 - Unlimited Marital Deduction
 - Highest Rate = 45%
 - Income Tax Basis is stepped-up (or stepped-down) to fair market value on date of death for most assets
 - Gift tax and estate tax not fully unified

Recent History and Current Law - Estate and Gift Tax

Applicable Exclusion Amount

Calendar Year	Estate Tax	Generation Skipping Transfer Tax	Gift Tax	Highest Tax Rate: Estate And GST Tax	Highest Tax Rate: Gift Tax
1998	\$ 625,000	\$1,000,000	\$ 625,000	55%	55%
1999	\$ 650,000	\$1,010,000	\$ 650,000	55%	55%
2000	\$ 675,000	\$1,030,000	\$ 675,000	55%	55%
2001	\$ 675,000	\$1,060,000	\$ 675,000	55%	55%
2002	\$1,000,000	\$1,100,000	\$1,000,000	50%	50%
2003	\$1,000,000	\$1,120,000	\$1,000,000	49%	49%
2004	\$1,500,000	\$1,500,000	\$1,000,000	48%	48%
2005	\$1,500,000	\$1,500,000	\$1,000,000	47%	47%
2006	\$2,000,000	\$2,000,000	\$1,000,000	46%	46%
2007	\$2,000,000	\$2,000,000	\$1,000,000	45%	45%
2008	\$2,000,000	\$2,000,000	\$1,000,000	45%	45%
2009	\$3,500,000	\$3,500,000	\$1,000,000	45%	45%
2010	[Estate Tax Repealed]	[GSTT Tax Repealed]	\$1,000,000	0%	35%
2011 (old law)	\$1,000,000	\$1,060,000	\$1,000,000	55%	55%

Proposed Legislation

- Repeal/No Repeal
- Exemption: \$2,000,000 - \$10,000,000
- Indexed for inflation
- Portable between spouses
- Estate tax rate – as low as top rate capital gains rate or as high as 55% + surtax
- Stepped-up (or stepped-down) income tax basis
- Valuation consistency for transfer tax and income tax
- Limited valuation discounts
- Minimum terms for GRATS
- Unification of estate tax and gift tax

Exemption Amount

- Proposals for estate tax exemption amount range from \$2,000,000 to \$10,000,000.

Indexed for Inflation

- Most proposals include provisions to index the exemption amount for inflation.

Portability Between Spouses

- If enacted, portability would allow the transfer of a deceased spouse's estate tax exemption to the surviving spouse.
- For example, with portability, if the deceased spouse passed away in 2008 when the exemption was \$2,000,000, and the surviving spouse passed away in 2009 when the exemption is \$3,500,000, the total exemption available to the surviving spouse would be \$5,500,000.
- In some cases, portability would reduce the complexity ⁷ of plans.

Top Rate

- Proposals for the top estate tax rate range from the top capital gains rate (currently 15%) to 55%, with a possible surtax of 5% on large estates under some proposals.

Income Tax Basis

- All proposals would continue the current provisions for a stepped-up (or stepped-down) income tax basis.

Valuation Consistency for Transfer Tax and Income Tax

- For income tax purposes, taxpayers who receive property by gift or inheritance would be required to use as the basis for the gift or inheritance the relevant value (in the case of a bequest) or donor's basis (in the case of a gift).

Limited Valuation Discounts

- Certain “applicable restrictions” on the right to liquidate an entity or sell real estate would be ignored in valuing interests in family-controlled entities and real estate, if those interests are transferred to or for the benefit of other family members.

Minimum Terms for GRATs

GRAT – Grantor Retained Annuity Trust

- These are irrevocable trusts to which the grantor (settlor) transfers property for the benefit of remainder beneficiaries, but reserves an annuity for the grantor for a specified term of years. Short term GRATs with large annuities can have little risk for the grantor but offer big estate tax savings if the property appreciates during the GRAT term. Proposed legislation would require a minimum GRAT term of 10 years.

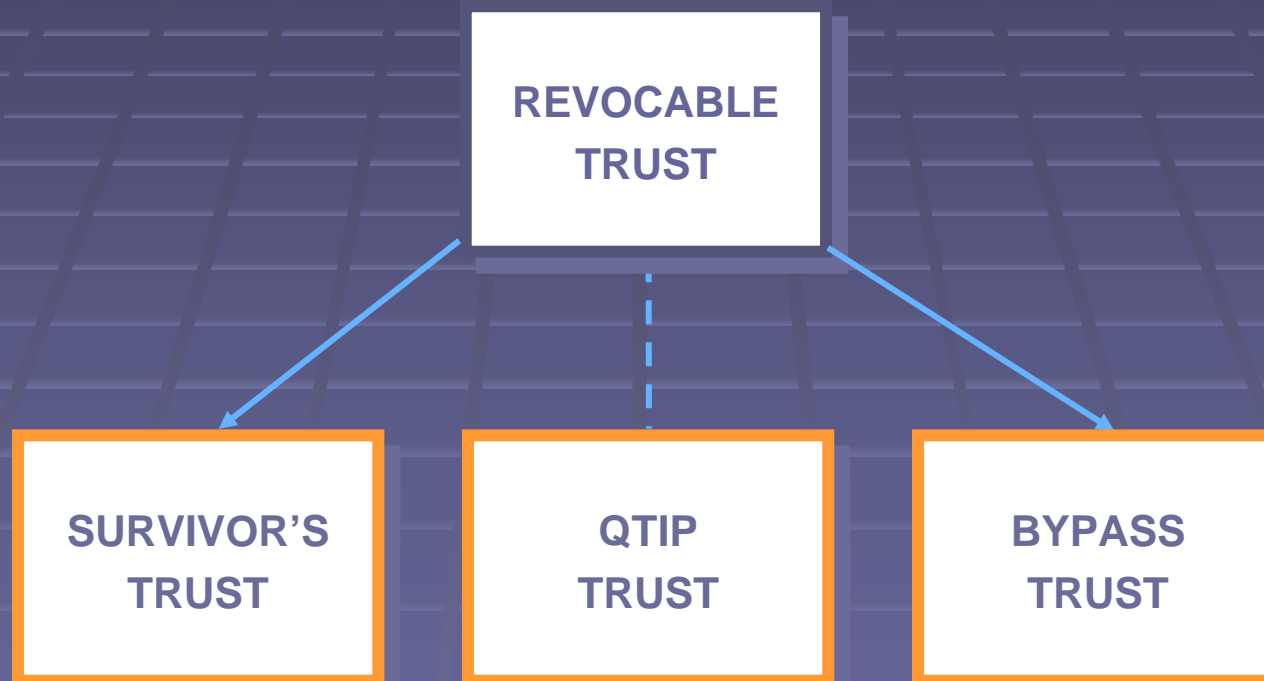
State Death Tax Update

- Many states (including California) have death taxes in the amount of the “state death tax credit.” These are sometimes called “pick up” taxes. When the state death tax credit was reduced to zero several years ago, these states’ death tax was reduced to zero also. However, given the difficult economic climate, many states are enacting state death taxes which are totally independent of the federal credit. And to make it more complicated, some of these state death taxes have a different exemption amount than that used by the federal government. So if you (as a California resident) own out-of-state real property, your estate may owe state death tax, even if it is below the federal estate tax exemption.

Planning In An Uncertain Time

- **Formula clause**
- **Survivor's/Disclaimer alternative**
- **Power to distribute Bypass Trust assets to surviving spouse**
- **Revisit annual exclusion gifts**

Estate Plan For Married Couple (*Traditional Plan*)



Traditional estate plan for married couple included mandatory division into two or three sub-trusts after first death.

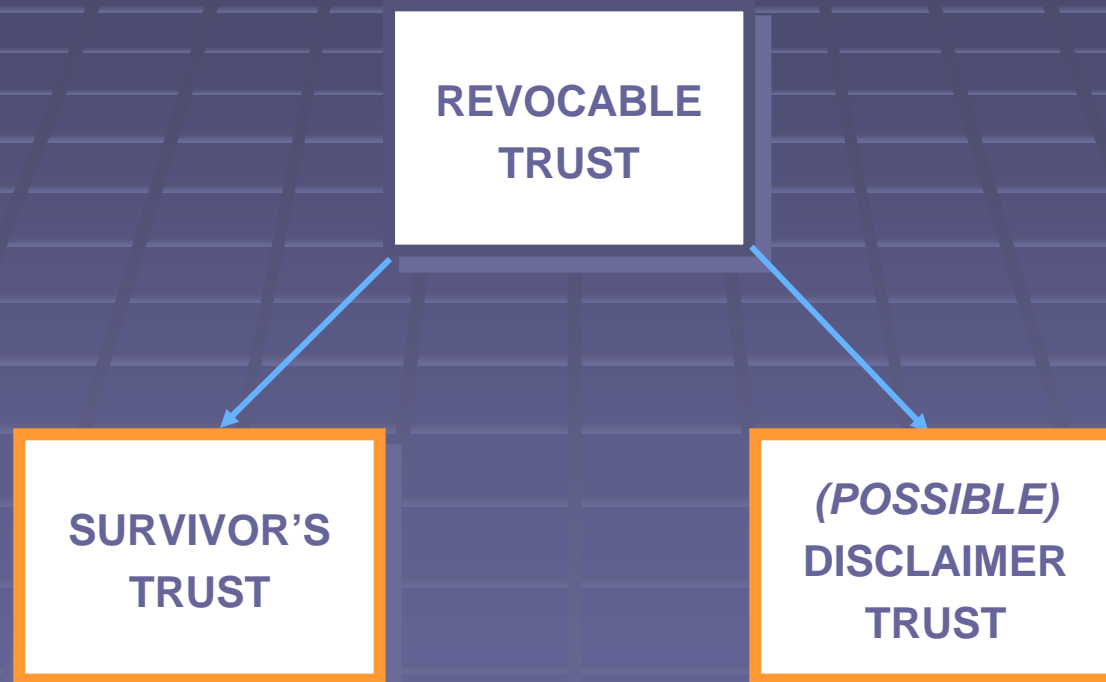
Traditional Plan Sub-Trusts

	Subject to Estate Tax on Death of Surviving Spouse?	Basis Adjustment on Death of Second Spouse?	Revocable?	Creditor Protection?
Survivor's Trust	Yes	Yes	Yes	No
QTIP Trust	Yes	Yes	No	Yes
Bypass Trust	No	No	No	Yes

Estate Planning With Larger Exemption Amount

- For a married couple with combined estate under \$3,500,000, the traditional estate plan can be simplified.
- If exemption becomes portable between spouses, then the estate plan for a couple with a combined estate under \$7,000,000 can be simplified also.

Estate Plan For Married Couple (*Simplified Plan*)



Simplified Plan Sub-Trusts

	Subject to Estate Tax on Death of Surviving Spouse?	Basis Adjustment on Death of Second Spouse?	Revocable?	Creditor Protection?
Survivor's Trust	Yes	Yes	Yes	No
Disclaimer Trust	No	No	No	Yes

Benefits of Simplified Plan

- Less record keeping and complexity for surviving spouse.
- Assets receive another step-up in basis upon death of surviving spouse.

Possible Downsides of Simplified Plan

- Reduced creditor protection for surviving spouse.
- Surviving spouse can change beneficiaries, potentially reducing or eliminating share for deceased spouse's children or other beneficiaries.
- Possible step-down in income tax basis upon second death.
- May not be optimal from GST tax standpoint.

Power to Distribute Bypass Trust Assets to Surviving Spouse

- Another way to add flexibility to an estate plan for a married couple would be to give the children the power to distribute assets of the Bypass Trust to the surviving settlor or the Survivor's Trust so they would be included in the surviving settlor's estate and receive a step-up in basis.

Revisit Annual Exclusion Gifting

- Annual exclusion will continue at \$13,000 in 2010.
- Like all gifts, annual exclusion gifts do not receive a step-up in basis. So if your estate is below the exemption amount, it may be most tax efficient to stop making annual exclusion gifts and allow assets to receive a step-up in basis after your lifetime.

Keeping Your Estate Plan Current

- Review your plan every five years
 - To ensure beneficiaries are current, and
 - To verify that successor trustees, executors, and agents under durable powers of attorney are willing and able to act, and
 - To verify that the plan continues to achieve your goals in light of changes in your family and financial status, the tax laws, and probate/trust laws.

Keeping Your Estate Plan Current (*continued*)

- Prepare updated list of assets and liabilities for use by successor trustees, executors, and agents under durable powers of attorney in the event of your death or incapacity. The list should include:
 - Name of Asset
 - Account Number (if any)
 - Account Manager Name and Contact Information