# Why Is This Environment A “Perfect Storm” For Estate Planning?

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On December 17, 2010, Congress enacted what we know as the 2010 Tax Act, changing the estate, gift and generation-skipping transfer (“GST”) tax regime. Before the passage of the Act, the federal estate tax exemption – the amount that an individual can pass to his or her beneficiaries tax-free – increased in steps from $675,000 per individual in 2001 to, ultimately, $3.5 million per individual in 2009. In 2010, the federal estate tax was eliminated; but only temporarily. Under prior law, the federal estate tax was scheduled to return in 2011 with a maximum tax rate of ***55 percent*** and a ***$1 million*** exemption, meaning that if a decedent’s estate exceeded $1 million, such excess would be taxed at a 55 percent rate.

The 2010 Tax Act extended the “Bush Tax Cuts” for only 2011 and 2012, but with a significantly higher gift and estate tax exemption amount of ***$5 million***, and a lower maximum tax rate of ***35 percent***. Beginning January 1, 2013, the Bush Tax Cuts will expire, and the law will revert to its 2001 status, unless there is further legislative action to make the 2010 Tax Act permanent or otherwise alter the transfer tax system. ***Absent legislation, the gift and estate tax exemptions are both scheduled to return to $1,000,000 on January 1, 2013, and the maximum gift and estate tax rates will increase to 55%.***

Clients are best advised to take advantage of the 2010 Tax Act and lock in the $5,000,000 gift exemption before it is lost. And remember, ***under current law, at least until December 31st of this year, you can make a gift of $5 million (or $10 million as a married couple) without incurring any tax whatsoever.***

Most of our clients hesitate to make large gifts regardless of the size of their estate. They are concerned about retaining enough money to live their lifestyle and what their kids would do with significant gifts. Below are a few of the most popular techniques we are implementing to take advantage of the “perfect storm” without risking your lifestyle or wasting your assets.

Lifetime Credit Shelter Trust:

A Lifetime Credit Shelter Trust is an irrevocable trust created by you for the benefit of your spouse and/or other family members. Gifting assets to such a trust removes the assets, and their appreciation, from your taxable estate. If you are married, a gift to such a trust can be particularly attractive because your spouse can be the primary beneficiary of the trust. ***This allows the assets to be removed from your taxable estate while still being available to your spouse and children.***

While the Grantor cannot have any direct access to the income or principal of the trust, the Grantor's spouse and children may have access to the income and principal of the trust. Upon the beneficiary spouse's death, the trust would typically be divided into equal shares for the benefit of each child.

Generation Skipping Trusts for Children:

If you and your spouse no longer need access to the assets you intend to gift, but are concerned about assets being gifted outright to your children, or if your children are minors, then generation skipping trusts would be appropriate for you. ***Generation skipping trusts are an extremely effective way to remove assets from your taxable estate, benefit your children and protect the assets from your children's creditors.***

To implement this type of trust, you and your spouse would gift up to $10 million (your combined gift tax exemptions) to a trust for the benefit of a child. During the child's lifetime, the income and principal of the trust could be used for the benefit of the child or his or her children (your grandchildren) at the discretion of the trustee. At the end of the child's lifetime, the child could designate who, among your descendants, would receive the remaining balance of the trust. If the child does not exercise this right, then the balance would be distributed among that child's children equally.

The reason that this trust is referred to as a "generation-skipping trust" is that the value of the trust not only escapes taxation at your death, but also escapes taxation at your child's death because your child will only be a beneficiary of the trust, not the owner of the trust. Therefore, these funds are passed down to your grandchildren without being subject to estate tax.

Also, any appreciation on these assets would also be removed from your estate. Business and/or real estate interests are excellent assets to gift because when they later appreciate that appreciation is removed from your estate.

Gifts to generation skipping trusts can also be enhanced by making the trust a “grantor trust.” A grantor trust is a special type of trust that will remove the assets from your estate, but which will require you to pay the tax on any income attributable to those shares held in the trust on your Federal income tax return. Why would you want to pay the income taxes for your child’s trust? Since you will be paying the tax on the income which the trust earns, that tax that you pay is really a benefit to the trust beneficiaries. Thus, it is like an additional gift that is not considered a taxable gift by the IRS. Really, it is like turbo-charging your gift.

An additional benefit that is often more important than the estate tax savings of a generation skipping trust is that the trust is typically not subject to the claims of your children’s creditors. ***Often they can be drafted in such a way as to prevent the trust assets from being subject to the claims of a spouse (or soon-to-be-former-spouse), as well.***

GRATS:

Because of low interest rates, the use of Grantor Retained Annuity Trusts (“GRATs”) has become very popular. A GRAT is created when a Grantor transfers one or more assets into an irrevocable trust while retaining the right to an annuity interest for a fixed term of years (paid from the assets of the trust). When the retained annuity period ends, the remaining assets in the trust (including appreciation) go to the named remainder beneficiaries, or remaindermen.

The tremendous benefit of a GRAT, and the reason why it is particularly effective for assets with a high likelihood of future appreciation, is that all income and principal appreciation in excess of the amount required to pay the annuity accumulates for the benefit of your children. Consequently, it may be possible to transfer assets to these beneficiaries when the trust terminates with values that far exceed their original values when transferred into the trust and, more importantly, that far exceed the gift tax value of the transferred assets.

***The window for taking advantage of the "perfect storm" for estate planning is likely coming to an end. Please talk to us about preserving your $5,000,000 gift tax exemption.***