TISSER LAW GROUP
Plan Early, Plan Well™

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THE STATE OF ESTATE PLANNING: 2012

THE FUTURE OF ESTATE TAXES

By: Doron M. Tisser

The year 2011 has been one of bewilderment, confusion and dissatisfaction with respect to estate and gift taxes. Simply stated, it has been difficult for many people to plan their estates without knowing what the future of the estate and gift taxes will be.

In order to look at the future, it is important to understand the past and how we arrived at the current state of estate and gift tax planning.

THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001

In 2001, our national government consisted of a Republican President (George W. Bush) and a Republican House and Senate. As a result, they passed The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA").

The Republican administration would have liked to repeal the estate tax in its entirety. However, because of budget constraints, they were not able to make the repeal permanent. On the other hand, the Democrats did not want to repeal the estate tax and, at the same time, did not want to raise the estate tax exemption as high as the Republicans did.

EGTRRA was a compromise in which the amount you could leave estate tax free (your "exemption amount") when you die was increased over time until it peaked at $3.5 Million in 2009. Under EGTRRA, the estate tax would be repealed in 2010 (so there would be no estate tax that year), and it would reappear in 2011 with an exemption amount of $1 Million (which is what it was in 2001).

Estate planning attorneys were sure Congress would pass legislation in 2009 either freezing the exemption amount at $3.5 Million or at some other amount so we would never see estate tax repeal, especially in those uncertain economic times where the government needs to raise revenue.

The House of Representatives passed estate tax legislation at the end of 2009, but the Senate did not act on the legislation, so on January 1, 2010, the estate tax law changes we did not think would occur in fact happened. This created a year of uncertainty and chaos that affected the estates of virtually everyone who died in 2010.

With respect to estates of people dying in 2010, trust and estate administration was put on hold. As far as we all knew, there were no estate taxes to pay, no estate tax returns to be filed and there would be no step-up in basis in inherited assets.

There were rumors throughout 2010 that Congress would change existing law to apply estate taxes retroactively as of the beginning of 2010. Because of these rumors and the surrounding uncertainty, trust administration for deceased persons came to a stand-still and clients were told not to distribute assets out of trusts until the law was settled.

THE TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT 2010

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act 2010 (the "TRA"). The purpose of the TRA was to eliminate the indecision over how to address certain estate planning issues, albeit on a temporary basis, by making most of its provisions retroactive to January 1, 2010. But in trying to clarify the estate tax laws, the TRA created new issues to which there were no clear answers.

The following is a comparison of the provisions under EGTRRA and TRA as they relate to estate and gift taxes.

ESTATE TAXES

EGTRRA: There were no estate taxes with respect to the estates of people dying in 2010.

For persons dying in 2011 and later, the amount that could be left estate tax free reverted to the 2001 level of $1 Million.

TRA: The 2010 Act repealed EGTRRA and retroactively reinstated estate taxes as of January 1, 2010. For persons dying in 2010, 2011 or 2012, the maximum amount he or she can leave estate tax free is $5 Million. If a person dies owning assets worth more than $5 Million, the maximum estate tax rate is 35% on the excess.

Because the TRA applies as of January 1, 2010, it requires that estate tax returns be prepared for persons dying in 2010 and estate taxes be paid, if applicable. In order to allow taxpayers to comply with this retroactive change, the TRA provided for a deadline of nine months after its enactment (i.e., September 16, 2011) in order to file the estate tax return and pay the estate taxes. In addition, a disclaimer of assets, which is typically required to be done within 9 months of the person's death, could be made by September 16, 2011.

For persons dying in 2010, an election to fall under EGTRRA (and thus not be subject to estate taxes) could be made. This would be useful for estates of persons dying in 2010 who were worth more than $5 Million and in which the family would rather give up the step-up in basis in exchange for not paying estate taxes.

For persons dying in 2012 and later, the amount that can be left estate tax free will be $1 Million.

STEP-UP IN BASIS

For tax purposes, you have a "basis" in assets, whether stocks, real estate or other assets. Your basis is defined, in general, as your purchase price for the assets. If you inherit an asset, your basis in the asset is the value on the date of death of the person you inherit from. This is called a "step-up in basis."

The purpose of having a basis in an asset is to determine how much tax you will pay when you sell the asset. When you sell an asset, you pay tax on the difference between what you sell it for and your basis.

As an example, assume you own a piece of real estate you bought for $25,000 (your basis) and it is now worth $100,000. If you sell it, you pay capitals gains tax on the difference between the sale price ($100,000) and your basis ($25,000), i.e., $75,000.

If you do not sell the real estate and your daughter had inherited the asset in 2009, she would have a basis of $100,000 (i.e., the value at the date of your death). If she sells it for $100,000, she would not pay capital gains tax and would be able to pocket all of the sales proceeds income tax free.

EGTRRA: In order to partially offset the loss of revenue because of the estate tax repeal in 2010, EGTRRA eliminated the step-up in basis for 2010, meaning a person inheriting an asset in 2010 would have had the same basis in the asset as the deceased person who died; this is known as a "carry-over basis."

TRA: With the reintroduction of estate taxes for 2010, the step-up in basis for that year was reinstated for those estates which elect to be under the estate tax laws enacted by the TRA.

For those estates who elect to be governed by the estate tax laws of EGTRRA, there would be no step-up in basis on assets inherited in 2010.

PORTABILITY

Portability means that if a spouse dies and is worth less than the amount he or she can leave estate tax free, the unused portion of his or her exemption amount can be used by the surviving spouse at his or her death. For example, if a person dies, has an exemption amount of $5 Million, but is only worth $2.2 Million at his death, the remaining unused $2.8 Million of exemption is added to the amount the wife can leave estate tax free when she dies. So if the wife has her own $5 Million to leave estate tax free, she can actually leave up to $7.8 Million estate tax free at her death, i.e., her $5 Million and her husband's unused $2.8 Million.

EGTRRA: EGTRRA contained no provisions for portability.

TRA: The TRA created portability between spouses for the first time, but the surviving spouse must die before 2013 to take advantage of the portability. If he or she dies in 2013, he or she will only have his or her own exemption amount to leave estate tax free.

To get the benefit of portability, an estate tax return must be filed even if it would not otherwise be required.

GIFT TAXES

You are allowed to gift a certain amount gift tax free during your lifetime, which is known as the gift tax exemption. This is in addition to the annual $13,000 per year gift you may make gift-tax free. Any gift in excess of your gift tax exemption amount is subject to a gift tax.

EGTRRA: Under EGTRRA, the gift tax exemption was $1,000,000, and the gift tax rate decreased gradually from 50% to 45% between 2002 and 2009.

TRA: The TRA provides that for 2010, the gift tax exemption was $1 Million, and for 2011 and 2012, the exemption is $5 Million.

For 2010, 2011 and 2012, the maximum gift tax rate is 35%.

For 2013 and future years, the gift tax exemption will be $1 Million and the maximum gift tax rate will be 55%

GENERATION-SKIPPING TAXES

The Internal Revenue Code imposes a generation-skipping tax (GST) on transfers to grandchildren or great-grandchildren.

EGTRRA: Under EGTRRA, the amount you could transfer to grandchildren without paying a GST increased gradually from $1 Million in 2002 to $3.5 Million in 2009, staying fairly consistent with the estate tax exemption. There were no generation-skipping taxes to be incurred if a client gave assets to grandchildren in 2010.

TRA: The TRA provides that for 2011 and 2012, there is a $5 Million generation-skipping tax exemption amount which allows a person to place up to $5 Million in a generation-skipping trust for children, grandchildren and other descendants, and avoid having those assets in the trust ever be subject to estate or generation-skipping taxes.

WHERE DOES ALL THIS LEAVE US NOW?

The future of the estate and gift tax laws is uncertain. It is often possible to predict the future based on past events. However, Congress' approach to changes in the tax laws has been erratic and unpredictable.

As of today, we know the estate tax exemption amount will revert to $1 Million in 2013 and the maximum estate tax bracket will once again be 55%. Congress will have to take affirmative action to change this law. But there are many questions that we are pondering.

- Will Congress change the law to raise the exemption?
- If yes, will the law be changed in 2012?
- Will the law be changed in 2013, retroactive to the beginning of 2013, as they did in 2010, leaving us with uncertainty and confusion for estates of persons dying in 2013?
- How will Congress view the country's current economic blight and need for additional tax revenues when addressing whether to increase the estate tax exemption amount?
- Will we have a Republican House and a Republican Senate after the 2012 elections?
- Will we have a Republican or Democratic President after the 2012 elections?
- How will Congress and the President work together on new estate and gift tax legislation?
- If the estate tax exemption is raised, will it be raised to $2 Million, 3.5 Million, $5 Million, or some other amount?
- Will Congress extend portability beyond 2012?
- Would Congress look at an extension of portability as a way of raising the estate tax exemption amount for a deceased spouse?

Debates surrounding these issues lead to one conclusion: no one knows what's going to happen. All you can do at this time is plan based on the current law, taking into account what you believe might happen in the future, with the understanding that if you decide not to take advantage of certain planning opportunities today and the law does not change as you expect it to, you will have lost a one-time tax planning opportunity.

Let's look at some of the tax planning opportunities you have.

ESTATE AND GIFT TAX PLANNING OPPORTUNITIES

For 2012, the maximum amount you can leave estate tax free and give gift tax free is $5 Million. Let's assume you do not plan on dying in 2012, so we are really talking about making gifts to family members in 2012.

If you do not take advantage of transferring assets to your family in 2012, there may be extra taxes your family will pay when you die.

For example, if you are worth $3 Million today and you die in 2012, there will be no estate taxes. But if you die in 2013, based on today's laws, there will be an estate tax of $945,000. If you gift your family $1 Million today and die in 2013, there will be an estate tax on your remaining $2 Million of $435,000. Just using part of the $5 Million gift tax exemption you have in 2012 can save your family almost $500,000.

If you are worth considerably more than $5 Million, you may want to consider making a gift to your family over more than $5 Million. It is true that while the first $5 Million will be tax free, the remaining gift will be subject to a gift tax. However, the gift tax today would be at 35% as opposed to a future estate tax of 55%, thus saving you family a tax of 20%.

The manner in which you make a gift to family also impacts the value. If you make gifts of partial interests in assets to family member, you may be entitled to a discount on the value, thereby allowing you to transfer more value to your family. For instance, if you structure a gift in a manner that would entitle you to a 33% discount on the gift, you could actually transfer $7.5 Million to your family at a discounted value of $5 Million (i.e., $7.5 Million less the 1/3 discount of $2.5 Million) without incurring gift taxes.

If you are married, you and your spouse could each transfer the amounts discussed above, thereby doubling the amounts transferred.

Another planning opportunity involves life insurance. If you own an insurance policy on your life, the proceeds will be subject to estate taxes when you die, even if your children are the beneficiaries. If the policy has a large cash value, using the $5 Million gift tax exemption is a great way of transferring the policy out of your estate at no tax cost. This could be done by transferring the life insurance into an irrevocable life insurance trust, designed specifically to own the life insurance on your life.

Remember, gifts you make to your children should be made to Lifetime Heritage Trusts for them to protect them from creditors, spouses and future estate taxes.

GENERATION-SKIPPING TRANSFER TAX OPPORTUNITIES

There is a certain amount you can gift to your grandchildren without incurring a generation-skipping transfer tax ("GST"). This amount is $5 Million for 2012, but will become $1 Million in 2013. Therefore, if you make a gift to a grandchild of $2.3 Million in 2013, you will have to pay not only a gift tax, but also a GST, which reduces the benefit of making the gift.

You may want to consider making a gift to grandchildren today of up to $5 Million in order to avoid the GST.

Gifts to grandchildren should be made to Lifetime Heritage Trusts for them to protect them from creditors, spouses and future estate taxes.

If you are married, you and your spouse can make up to $10 Million in gifts in 2012 to grandchildren without incurring GST.

PORTABILITY OPPORTUNITIES

Currently, the benefits of portability only apply if one spouse dies in 2011 or 2012 and the surviving spouse dies in 2012.

In order to get the advantage of portability, an estate tax return must be filed, even if it would not otherwise have been required.

Why then, you may ask, would you want to file an estate tax return for your deceased spouse if you do not think you will die in 2012 and be able to take advantage of portability.

Excluding the possibility you may die in 2012, there is the possibility that Congress may extend portability beyond 2012. If you do not take advantage of portability now, by filing an estate tax return for a deceased spouse, you may lose the benefit of portability when you die.

Remember, the TRA was the first time portability was introduced into the estate tax laws, even though it had been discussed for many years. There is a good chance that now it has been introduced into the law, Congress will be hesitant to repeal it.

Another possible question with respect to portability is whether you should still create a bypass trust (Decedent's Trust) to take advantage of your deceased spouse's unused exemption amount, or you should instead elect portability. For a variety of reasons, it is generally more advantageous to use a bypass trust to protect the deceased spouse's assets from future estate taxes. The bypass trust will protect those assets from the surviving spouse's creditors, a new spouse and from future generation-skipping transfer taxes.

Another advantage of the bypass trust over portability is that the growth in assets in the bypass trust are protected from future estate taxes when the surviving spouse dies, which is not the case with portability.

Do not assume that just because of portability, you should not use a bypass trust.

CONCLUSION

If you look at what has happened with the estate and gift tax laws in the last few years, you will come to realize it is impossible to predict what will happen in the future.

For example, the TRA became law in December 2010 and allowed estates to use the prior 2010 estate tax laws providing for no estate taxes, and giving up the step-up in basis. This election was to be made on a form required to be filed by September 19, 2011. The Internal Revenue Service released a proposed draft of the form to be filed, but was inundated with questions and corrections and had to go through several more versions of the form. In the meantime, September 19 came and went and taxpayers were unable to file the election because the form had not been issued by the IRS. The IRS then extended the date to file the form until January 2012.

Just the confusion with this one form to be filed to elect to use the old estate tax laws gives you a view into how complicated the estate tax laws are and difficult it is to come up with a form for tax elections.

There have been proposals by various members of the House and Senate to increase the estate tax exemption amount to various levels, ranging from $2 Million to $5 Million as of 2013, but none of these have gone anywhere.

In fact, several Republican members of Congress have gone on record saying that they will not vote for an increase in the estate tax exemption amount during an election year (for fear of losing their seat) nor while the country in is economic turmoil (fearing that their constituents will see the vote as a direct benefit only to the very wealthy).

Remember, government officials estimated that only approximately 6,000 persons were expected to die in 2009 owing estate taxes, when the estate tax exemption amount was $3.5 Million. This number is not much higher for persons dying with a worth of $1 Million.

The only thing we are certain about is that this year's estate and gift tax laws are more favorable to taxpayers than at any time since the creation of the estate tax. With this in mind, we are encouraging everyone who is interested in exploring ways to protect his or her estate from estate taxes to consider taking action before the current law expires.

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Doron M. Tisser, Esq., the Firm's founder, has been engaged in private law practice in California since 1982, with an emphasis in the areas of estate and gift planning, tax planning, trust administration, probate, business and succession planning, and charitable giving. He graduated 2nd in his class from Southwestern University Law School in Los Angeles and received his Masters Degree in Taxation (LL.M.) from New York University School of Law.

Doron has been designated as a Certified Specialist in Probate, Estate Planning and Trust Law, and as a Certified Specialist in Taxation Law by the State Bar of California Board of Legal Specialization. He is one of less than approximately 100 attorneys in California (out of approximately 160,000) who have earned both these Board Certifications.

Among Doron's specialties is that he is able to explain sophisticated and difficult concepts to clients in an easy-to-understand way, allowing clients to understand how various estate and tax planning techniques will affect their estate plans.

Doron has been quoted and referenced in many magazines and newspapers across the country including Forbes Magazine, US News & World Report, Wall Street Journal, Los Angeles Times, and Entrepreneur Magazine.

Doron has authored over 65 articles and chapters in books on various estate and tax planning subjects, including booklets on A Guide to Planning Your Estate, A Guide to Trust Administration, and A Guide to Advanced Estate Tax Planning Techniques. He has published articles and materials for Estate Planning Magazine and for California Continuing Education of the Bar. In addition, Doron has authored chapters on "Corporate Buy-Sell Agreements" and "Partnership Buy-Out Agreements" for Counseling California Corporations, published by the California Continuing Education of the Bar.

Doron has been a frequent speaker and lecturer at estate and tax planning conferences and seminars, including those presented by the California State Bar, California Continuing Education of the Bar, California CPA Education Foundation, Society of Financial Service Professionals, Life Insurance Leaders' Round Table, and various other professional organizations. Doron has taught at UCLA, USC and California Lutheran University.

In addition to being chosen by his peers as a Super Lawyer in 2009, 2010 and 2011 for Southern California, Doron has been awarded the highest possible rating by his peers, an "A.V." rating, for the Martindale-Hubbell Law Directory. This rating is based on ethical considerations and legal skills. Each year, no more than 5 percent of the lawyers in the state receive this honor. He has been elected to Who's Who in American Law, Who's Who in Practicing Attorneys, Who's Who of Emerging Leaders in America, Presidential Who's Who and Marquis' Who's Who in the World.

Doron enjoys competing in running races and triathlons. He has run 13 marathons, including the Boston, New York City, Los Angeles, Surf City and Silicon Valley marathons. He has completed two Ironman triathlons, which consist of a 2.4 mile swim, 112 mile bike ride and a 26.2 mile run, and other triathlons, including the California Half Ironman, Big Kahuna Triathlon, Carlsbad Triathlon, the 5430 Triathlon
(in Boulder, Colorado) and the Nautica Malibu Triathlon.

Doron co-founded Team Tisser Foundation (TTF), a non-profit corporation, which raises money for charitable causes. He raises money through his athletic training and racing. Through TTF, Doron has raised over $250,000 in donations for various charities, including the Aubrey Fund for Pediatric Cancer Research at Memorial Sloan-Kettering Cancer Center, the Leukemia & Lymphoma Society, and Challenged Athletes Foundation. For more information on TTF, see Team Tisser.

One of Doron's proudest moments was at the 2007 Ironman Coeur d'Alene when he was honored by the Janus Charity Challenge for raising over $41,000 for TTF by competing in that race.

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