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An Invitation  
Cohen and Wolf, P.C.  
 cordially invites you to celebrate  
the opening of its new office  
in the former United Illuminating Building  
115 Broad Street, Bridgeport, Connecticut  
Thursday, November 17, 1983 4:30 to 7:30 PM

## Federal Estate Tax Rules for 2011 and 2012

02.16.2011

President Obama signed a new tax bill on December 17, 2010, entitled "The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," or more fondly referred to as the "Tax Relief Act" or "TRA." This bill includes an extension of various provisions of the Bush era tax cuts; but it also makes significant changes in the tax laws affecting estates (and therefore, the estate planning of our clients). This bill also impacts the estates of persons who died in 2010.

We have posted an article on our website about the impact of this bill on estates of clients who died in 2010. If you have a family member who passed away in 2010, please go to [www.cohenandwolf.com](http://www.cohenandwolf.com) and you will find the article under "Publications." It will guide you in making decisions that affect the tax planning of assets that you will receive from those estates.

From an estate planning point of view, if you have not conferred with us in a few years, you may now want to take the opportunity to review your planning to see if changes are warranted, given the new estate tax environment. Please note that these changes apply to 2011 and 2012. The extension of the Bush era tax cuts and the new estate tax rules apply only for those two years, and then the old law returns.

Below is a summary of some of the TRA provisions as they affect estate planning. The provisions that affect income taxes are discussed in a separate article also found on our website.

### **ESTATE, GIFT AND GENERATION SKIPPING TAX PROVISIONS OF NEW TAX BILL**

For persons dying during 2011 and 2012, the estate tax exemption will be \$5,000,000. The TRA also increases the generation skipping tax exemption to \$5,000,000. Congress must revisit the estate tax laws before the end of 2012, otherwise we will revert to pre 2001 level of a \$1,000,000 exemption – here we go again! In addition, for the next two years, the top marginal rate of federal estate tax is lowered to 35% (which also therefore lowers the generation skipping tax rate to 35%).

The return to a unified gift and estate tax system is a welcome change. Prior to this year, based on earlier changes in the law, the gift tax exemption (after applying the annual exclusion of \$13,000) was \$1,000,000 per person (the lifetime exemption). This lower gift tax exemption limited the opportunities for high net worth clients to use gifts as a technique to lower federal estate taxes. Now that we have returned to a unified system, individuals may make gifts during lifetime of up to \$5,000,000 (reduced by amounts used in prior years) without any current federal gift tax cost. This offers high net worth individuals many opportunities for tax planning during the next two years, while this increased exemption is in place.

### **NEW CONCEPT: PORTABILITY**

Another change is the introduction of a new concept, called "portability." You may hear this buzz word used often in the next few years when engaging in your estate planning. Portability is the provision in the new tax law which allows a surviving spouse to inherit the unused exemption of \$5,000,000 from his or her deceased spouse, if the deceased spouse did not fully use the exemption. Theoretically, this could mean clients who are married no longer need to create a "credit shelter trust" in the estate of the first spouse to die (funded by the exemption amount).

For example, assume Mr. and Mrs. Smith have a combined estate of \$7,000,000, including real estate and life insurance. Also assume that Mr. Smith dies in 2011, with a Last Will and Testament that leaves everything to Mrs. Smith, except a life insurance policy of \$1,000,000 payable to Mr. Smith's children. This means that Mr. Smith will be using \$1,000,000 of his exemption, because all assets left to Mrs. Smith are tax free based on the marital deduction.

If Mrs. Smith dies in 2012, her federal exemption becomes \$9,000,000 (her own exemption of \$5,000,000 plus her husband's unused exemption of \$4,000,000). This will be more than adequate to shelter her estate of \$6,000,000 from assets (the combined \$7,000,000 reduced by the \$1,000,000 left earlier to Mr. Smith's children). Please note, however, that Connecticut has not adopted the concept of portability, so only one exemption of \$3,500,000 can be applied to Mrs. Smith's estate for Connecticut estate tax purposes.

There are a number of disadvantages to portability, so it may not be very usable for our clients. First, as stated above, Connecticut does not recognize this concept. Second, it applies to the "last deceased spouse," so if Mrs. Smith marries again to someone who then dies, using his full exemption, she loses her ability to inherit the exemption of her first spouse. Mrs. Smith cannot "collect" exemptions from multiple spouses.

A third more significant disadvantage to using portability in your estate planning is what happens between the death of the first spouse and the death of the surviving spouse (assuming no remarriage).

The inherited exemption does not increase. However, the assets that Mrs. Smith inherits from her husband could increase. Assume Mrs. Smith dies 10 years after Mr. Smith and she still has portability. If invested wisely and not spent, her inheritance from her husband could double. If her assets at death doubled in value (became \$12,000,000), then there would be a federal estate tax. If alternatively, Mr. and Mrs. Smith created an estate plan that caused a trust to be set up when Mr. Smith died (a “credit shelter trust”), then Mrs. Smith’s estate would be only \$4,000,000 in that example (the credit shelter trust would have been funded with \$4,000,000 at Mr. Smith’s death, leaving Mrs. Smith with \$2,000,000 of her own assets, which we assumed doubled before she died).

Finally portability is set to expire in 2012 (although it could be extended), so any estate planning we create for our clients needs to be flexible.

Please note that the generation skipping exemption is not portable, so if that is an issue for planning, the credit shelter trust is the preferable vehicle.

You can read more about “portability” in a separate article on our website.

#### **DO WE NEED TRUSTS ANYMORE?**

The changes in the estate tax laws do not necessarily mean that trusts are not warranted in estate planning for our clients of any net worth. Trusts are still necessary for young children, planning for couples in second marriages, asset protection of beneficiaries, planning for long term care or special needs, to protect against the loss of family assets in a child’s divorce, and perhaps for financial management reasons.

Finally, since Congress could decide to reduce the estate tax exemption in the future, even clients whose assets do not exceed the federal or state exemptions currently in effect may be well advised to have documents that contain credit shelter trusts that can be funded by having the spouse disclaim assets – just in case. As noted above, until we have more certainty, flexibility is the key.

#### **ESTATE PLANS SHOULD BE REVIEWED**

In any event, no estate plan should be established and then ignored. These plans should be reviewed every few years by our clients because their lives change and these changes may have a greater impact on their planning than any tax law changes that come along. Please contact any of us in the Tax, Trusts and Estates Practice Group at Cohen and Wolf, P.C., if you want to review your estate planning and discuss these changes in greater detail.

#### **PRACTICE AREAS**

Tax

Trusts & Estates

