

LEGAL UPDATE

January 2011 By: Richard L. Kay, Tracy Green Landauer, Eric B. Woldenberg and Alan S. Laufer

TIME TO CHECK YOUR WILL AND CONSIDER EXPANDED GIFT OPPORTUNITIES

The changes in the estate and gift tax laws contained in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Law") have given us much to consider. For 2011 and 2012 there is a unified \$5,000,000 estate, gift and generation skipping tax exemption amount, and a maximum estate and gift tax rate of 35%, plus the new concept of "portability," whereby a surviving spouse is permitted to take advantage of the unused estate tax exemption of his or her predeceased spouse.

This is good news for those wishing to gift significant assets, but the Law can also have negative consequences under certain common will language. Those who do not review their wills to determine the Law's effect on them can find themselves with (1) a significant state estate tax bill, and (2) inadequate provision for the surviving spouse.

REVIEW YOUR WILL UNDER THE NEW ESTATE TAX RULES

Problem formulas in existing wills. Many wills have been drafted to minimize federal estate taxes through the use of a "credit shelter trust." Common formulas fund such a trust (which may, or may not, include the surviving spouse as a beneficiary) with the maximum amount that can pass free of federal estate tax. Now that this number has been increased to \$5,000,000, the estates of residents of states like New York and New Jersey (whose wills contain such a provision) could incur a state estate tax bill of approximately \$400,000. This is because those states' exemption amounts are \$1,000,000 and \$675,000 respectively, and amounts passed to such trusts over the state exemption levels will be subject to state estate tax.

Another potential problem will occur under wills that do not include the surviving spouse as a beneficiary of the credit shelter trust. In this case, if the estate does not exceed \$5,000,000, the surviving spouse could be unintentionally omitted. Both of the above results can easily be avoided by changing the will.

Portability. The new concept of "portability" has received much attention in the news. In short, it

allows a surviving spouse to take advantage of any unused exemption of the deceased spouse to shelter additional assets from tax. While this may prove useful for many couples, it does not eliminate the need for careful review of existing estate plans. Portability works as follows: if Husband dies first with a taxable estate of \$2,000,000, Wife will have an available exemption of \$8,000,000 (her \$5,000,000 plus Husband's unused exemption of \$3,000,000), if the circumstances meet the Law's requirements. One important detail is that a surviving spouse is only entitled to the unused estate tax exemption of his or her *last* predeceased spouse. If Wife in our example subsequently remarries Second Husband, who then predeceases Wife with a taxable estate that uses up his entire exemption, Wife is only entitled to her own exemption (\$5,000,000), and the unused exemption of her first Husband (\$3,000,000) will be lost.

This loss of exemption may be avoided through proper planning. Traditional credit shelter trusts funded with the amount that can pass free of both federal and state estate taxes (\$1,000,000 for New Yorkers) or other forms of trusts may still provide benefits. But of much greater appeal are trusts known as "disclaimer trusts," which permit great flexibility and have both tax and non-tax benefits.

Disclaimer trusts. The decision to create a disclaimer trust, and to determine the amount with which it is funded, is left to the surviving spouse. The will is structured so that, if the surviving spouse disclaims (renounces) property that he or she would otherwise receive from the deceased spouse, that property passes to a trust that is usually held for the benefit of the surviving spouse and descendants. The decision as to how much, if any, property to disclaim into the trust must be made within nine months of the date of death. Unlike outright ownership of assets by the surviving spouse, creation of a trust for the benefit of the surviving spouse provides both tax savings and creditor protection, shields appreciation in the value of trust assets between the 1st and 2nd death from tax, permits better generation-skipping tax planning, and avoids forfeiture of portability through remarriage of the surviving spouse.

CONSIDER GIFTING IN 2011 AND 2012

For those who wish to pass significant assets to family and friends, now is the time under the \$5,000,000 exemption currently in effect. Until January first, the gift tax exempt amount was \$1,000,000. Thus even those who had fully utilized the exemption now have an additional \$4,000,000 of available exemption. Options for individuals with taxable estates to consider include the following:

- Gifts to heirs, or to non-citizen spouses, aggregating up to the \$5,000,000 lifetime exemption amount (either outright, or as seed money for a sale to an intentionally defective trust) should be considered, especially where property that is potentially appreciating in value can be transferred, and valuation discounts are available (including interests in family partnerships or LLCs, and certain corporate stock)
- Cash value life insurance policies owned by the insured (up to the \$5,000,000 lifetime exemption amount) could be transferred out of the estate of the insured into irrevocable trusts to avoid later estate inclusion of the full policy proceeds

- Gifts to grandchildren or other “skip” generation individuals can be transferred up to the \$5,000,000 generation-skipping transfer tax exemption
- A grantor retained annuity trust (“GRAT”) can be created while short term GRATs are still permitted by law.

We urge you to review your current estate planning documents so that your intentions are not undermined by recent changes in the law.

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The foregoing is merely a discussion of the Federal Estate and Gift Tax Laws. If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact the following attorneys:

Richard L. Kay

212-326-0844

rkay@pryorcashman.com

Tracy Green Landauer

212-326-0253

tlandauer@pryorcashman.com

Alan S. Laufer

212-326-0403

alaufer@pryorcashman.com

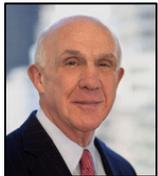
Eric B. Woldenberg

212-326-0865

ewoldenberg@pryorcashman.com

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ABOUT THE AUTHORS



RICHARD L. KAY

Partner

Direct Tel: 212-326-0844

Direct Fax: 212-798-6919

rkay@pryorcashman.com

Richard L. Kay joined Pryor Cashman in 1987 as the partner in charge of the Trusts and Estates Group and continues in that capacity. He specializes in all aspects of financial and estate planning and trust and estate administration, as well as litigation relating to will contests, disputed accounting proceedings and similar matters.

Richard has broad experience in representing a diverse client base including wealthy family groups, individuals and corporate executives and has considerable expertise representing estates and individuals with significant literary assets. He has received numerous appointments in Surrogate's Court, New York County and New York Supreme Court as Guardian ad litem.



TRACY GREEN LANDAUER

Partner

Direct Tel: 212-326-0253

Direct Fax: 212-515-6955

tlandauer@pryorcashman.com

Tracy Green Landauer organizes and provides ongoing and special issue representation to tax-exempt organizations including arts, charitable, community, literary, research and trade organizations.

Tracy counsels her tax-exempt clients with regard to:

- Issues of formation, exemption, board governance and policies, and organizational structures
- Compensation planning
- IRS and state reporting requirements and audits
- U.S. tax compliance issues in domestic and international grant-making
- Unrelated business income, prohibited transactions and operational issues
- Compliance with state fundraising/solicitation requirements for print and electronic media

Tracy also provides personal estate, tax, charitable gift and retirement planning to a broad range of individuals, tailoring plans to the needs and goals of each client.

Tracy provides:

- Comprehensive estate plans for business owners, professionals, artists, entrepreneurs and others
- Gift, estate and generation-skipping transfer tax planning
- Business succession plans
- Charitable gift and income tax planning
- Multi-generational wealth preservation plans
- Administration of decedents' estates and trusts



ALAN S. LAUFER

Associate

Direct Tel: 212-326-0403

Direct Fax: 212-798-6303

alaufer@pryorcashman.com

Alan Laufer is an associate in the Trusts and Estates Group. He joined Pryor Cashman in 1997. Alan specializes in all aspects of estate planning, estate administration, litigation in the Surrogate's Courts, and laws affecting charitable organizations.

Alan's practice includes drafting and structuring complex wills, trusts, agreements and other estate planning documents; representing executors, trustees and beneficiaries in difficult estate administration issues; and representing fiduciaries before the Internal Revenue Service and state taxing authorities in connection with estate and gift tax issues. Alan has successfully litigated will contests, disputed administrations and accountings and actions against fiduciaries.

Alan has represented clients in connection with complex issues involving the organization and administration of charitable organizations, including public charities, private foundations, charitable lead trusts and charitable remainder trusts; obtaining tax exemption of charitable organizations from the Internal Revenue Service; potential excise tax liability of charitable organizations and managers of charitable organizations; and state law issues regarding charitable organizations, including issues regarding corporate governance and compliance with charitable solicitation laws.

Immediately prior to joining Pryor Cashman, Alan was a sole practitioner, practicing law and accounting. He specialized in trusts and estates law, tax law, pension and ERISA law and public accounting.

Alan received an LL.M. in Taxation from New York University College of Law in 1984. He received a J. D. from Syracuse University College of Law and an M. S. in Accounting from Syracuse University College of Business Administration in 1978, where he was Technical Editor of the Syracuse Journal of International Law and Commerce and a member of the Moot Court Board. Alan received a B.A. in Geology from State University of New York at Binghamton in 1975.

Alan has been a Certified Public Accountant in New York State since 1980.



ERIC B. WOLDENBERG

Partner

Direct Tel: 212-326-0865

Direct Fax: 212-798-6923

ewoldenberg@pryorcashman.com

Eric B. Woldenberg joined Pryor Cashman in 1984 and has been a partner since 1988. Eric is the Chairman of the Tax Group and specializes in taxation and estate planning. Eric has extensive experience in negotiating and structuring a broad range of transactions, including mergers and acquisitions of both private and public companies. A significant portion of his practice is devoted to estate and tax planning for high net worth individuals and families. Eric is regularly involved with tax controversy work involving federal and state tax matters.