What Spouses Are Good For In 2011 And 2012

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Lots of things, obviously! In context of tax and business, a number of specific items (not exhaustive), including:

a. Creditor protection via the special protections afforded by property held jointly as tenants by the entireties (in those states recognizing such tenancies and protections, such as Florida);

b. Use of gift splitting to double annual exclusion gift amounts to a specific beneficiary;

c. Use of two unified credit amounts to make larger gifts; and

d. Decontrolling entities for valuation reduction purposes.

But there is nothing special about those items for 2011 and 2012. What is special for these two years is the $5 million unified credit amount for gift and estate tax purposes. This is the highest amount by far ever permitted, and it is scheduled to revert to $1 million on January 1, 2013.

Many high net worth families will want to take advantage of all or a part of this high amount to make gifts free of estate tax before 2013. If such amounts are used to establish long-term trusts for family members and are properly structured for generation-skipping tax exemptions, dynasty trusts that can pass assets through several generations without incurring estate, gift or generation-skipping tax can established.

Many parents are not eager to establish trusts for children or grandchildren. It may be because they want to hold on to the subject assets in case needed for their own future living expenses if their circumstances change, or perhaps they don’t want to “spoil” their lineal descendants with a large trust for them while they are young.

The benefit of being married is that each spouse can create a gift trust, naming the other as the current beneficiary, instead of (or in addition to) a younger generation beneficiary. This trust need not require current distributions, so it can grow over time and eventually pass to the children or younger generations when the parents die. Importantly, the parents will have access to the funds if needed during lifetime, as beneficiary of each other's trust.

The trusts can be grantor trusts, so that the spouses will be directly taxed on the income of each trust and allowing the trusts to grow in an income-tax free environment. The trusts can also use a formula funding clause and variable dispositive provisions based on QTIP treatment, to allow partial QTIP treatment and division, if funded with difficult-to-value assets. This avoids the risk of the IRS successfully challenging the values to create a taxable gift over the remaining unified credit if that credit amount is exceeded. It may also allow for more aggressive valuation planning on in-kind funding of the trust.

Care must be taken, however, to avoid the application of the reciprocal trust doctrine. This is not difficult to accomplish, as long as one is conscious of the need for such planning.

This type of planning is not without its drawbacks, but all-in-all it provides significant benefits. It should be considered by those families with spouses in the older generation that are planning to use all or a portion of the enhanced unified credit in 2011 and 2012.

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