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ESTATE TAX UPDATE: PORTABILITY OF THE 2011 ESTATE TAX EXEMPTION

On December 17, 2010, the President signed "The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" (the "Act"), which, among its provisions, enacted significant changes to the estate tax law. Of the many revisions to the estate tax law in the Act, the concept of portability of the estate tax exemption has received the most publicity.

Under the Act, for individuals dying after 2010, the estate tax exemption will be $5,000,000 per individual for 2011 and 2012 with a tax rate of 35% on the amount exceeding the exemption. In the past, in order to take advantage of the estate tax exemption, the estate planning documents of a married couple would have required the use of a "credit shelter trust". The first spouse to die would allocate assets equal to the estate tax exemption ($3,500,000 in 2009 and $5,000,000 in 2010, 2011 and 2012) in a trust for the surviving spouse so that when the surviving spouse subsequently dies, the amount in trust will then pass to descendants free from estate tax. Beginning in 2011, the concept of portability has been introduced so that if this technique is not used, the surviving spouse has an opportunity to use both exemptions without any advanced planning and can shelter $10,000,000 from estate tax. While this was meant to facilitate planning, there are a number of serious flaws with relying on this provision:

- Portability only extends to the "last deceased spouse". In other words, assume Husband dies in 2011 and Wife remarries and New Husband dies in 2012 leaving his estate to his children from his first marriage. When Wife dies, she only has a $5,000,000 (not a $10,000,000) estate tax exemption. In essence, there is no ability to "collect" exemptions through remarriage.

- The credit shelter trust can be used as a hedge to ensure that any future appreciation is sheltered from estate tax and that the combined assets of a married couple stay within the $10,000,000 exemption.

- Portability is set to expire after December 31, 2012. Assume Husband dies in 2011 without sheltering his $5,000,000 exemption in a "credit shelter trust" and leaves everything to Wife in the hopes that she will be below the $10,000,000 combined exemption. If Wife dies many years later under a new tax regime with a lower exemption, the couple incorrectly gambled and wasted an opportunity to save estate tax in exchange for simple planning.

- There is no portability for generation-skipping planning, so if the ultimate goal of the estate plan is to keep the assets in the bloodline and away from sons-in-law and daughters-in-law, Wills must have credit shelter trusts.

- Trust planning is still necessary (i) for asset protection purposes since assets in a trust are generally exempt from the creditors of the beneficiary, (ii) to protect from remarriage where the new spouse could receive assets instead of children, (iii) to insulate the surviving spouse from the son-in-law who wants financing for a business venture which may not be a prudent investment, (iv) to provide the surviving spouse with a formal structure to manage the estate assets and avoid mismanagement

or (v) to avoid problems if the surviving spouse is unable to manage finances by reasons of dementia or similar disorders.

The Act proves the proverb that there is nothing permanent except for change. Now is the time to review your estate plan to determine whether changes need to be made and whether additional planning is needed. ■

Please call Harris Markhoff, Esq., or Michael Markhoff, Esq., to review your estate plan or to discuss these issues in greater detail.

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