

Status of the Estate and Gift Tax Laws under the New Administration



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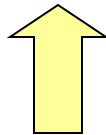
The Candidates' Estate Tax Proposals

OBAMA

- \$3.5 Million Exclusion
- 45% rate

McCAIN

- \$5 Million Exclusion
- 15% rate



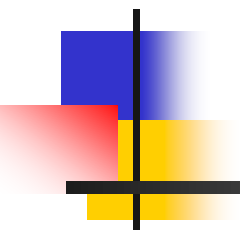
The Winner!



Obama Tax Rate Increases

- Restores 36% & 39.6% rates on Highest Income Taxpayers
- Capital Gains Taxes raised 15% to 20%
(Married taxpayers with AGI > \$250k; \$200k for others)
- 4-5% Payroll Tax on Wages > \$250k
- Encourages Trust Distributions to Beneficiaries in Lower Tax Brackets

**ESTATE
TAX
REPEAL?**





CARRYOVER

BASES ?




SEPARATE GIFT & ESTATE TAX EXCLUSIONS?

- \$1M Gift Tax Exclusion Amount
- \$3.5M Estate Tax Exclusion Amount

Current Law – Federal Exclusion “See Saw”

Tax Year	2008	2009	2010	2011
Federal Estate Tax Exclusion	\$2M	\$3.5M	\$5M	\$5M



“Throw Grandma from the Train” Year



How Did We Get Ourselves Into this Mess?

- Prior History - 2001 Tax Act
 - Passed Primarily on Party Lines
 - Not a Bipartisan Deal
 - Expiration of Provisions in 2011 (“**The Sunset**”)
 - Greatly reduced Costs of Tax Cuts
 - Avoided Senate Rule requiring 60 votes for Permanent Tax Cuts
- Tax Policy Lesson: **Sunset Provisions are BAD**
 - There SHOULD be no more “temporary” tax cuts dependent on a future Congress to make such cuts permanent!



The Mother of All Messes: Estate Tax “DeCoupling”

- Prior to 2001 Tax Act -
 - Most States “Picked-up” a % of Federal Estate Taxes via the IRC 2011 “State Death Tax Credit”
 - Effectively a Form of Revenue Sharing
- After 2005 –
 - States no Longer Received a % of Federal Estate Taxes (the IRC 2011 Credit is Repealed)
- Many States in Response “Decoupled” and Enacted Separate Estate Tax Laws based on Repealed IRC 2011 Credit



Aftermath of “DeCoupling”

(See Attachment #1)

- 24 States - NO State Estate Taxes
 - Wisconsin, Michigan, Florida etc.
- 26 States have State Estate Tax Laws
 - 5 States - based on degree of kindred
 - 20 States (IL included) - based on Repealed 2011 State Death Tax Credit
- Trap: IL Decedent with Non-IL Real Estate



The IL Decoupled Estate Tax

- 2009 - \$2M IL & \$3.5M Federal Exclusion
- Current Law:
 - 2010: Repeal of Federal & IL Estate Taxes
 - 2011: **Reinstatement** of IL Estate Taxes
(based on "Sunset" of 2001 Tax Act)
- Expected 2009 Change: \$3.5M Permanent Federal Exclusion = **Repeal** of IL Estate Taxes
(If Illinois Law doesn't subsequently change)



The IL Legislature Will Decide the Future of IL Estate Taxes

- If Permanent \$3.5M Federal Estate Tax Exclusion Becomes Law,
- the IL Legislature Must Affirmatively Act to Reinstitute the Illinois Estate Tax.



2009 Tax Law Dilemma

- \$3.5 Federal Exclusion Amount
- \$2M Illinois Exclusion Amount
- Death of 1st Spouse, is Credit Shelter Trust Funded at:
 - \$3.5M, \$2M or something else?
 - It all Depends on Facts & Assumptions

#1 Credit Shelter Funding-\$7M

Credit Shelter Trust – (1 st to Die)	Option #1 \$2M	Option #2 \$3.5M
Marital Share to Surviving Spouse	\$5M	\$3.5M
IL Taxes - 1 st to Die	\$0	\$209k
Federal & IL Taxes – 2 nd to Die	<u>\$869k</u>	<u>\$209k</u>
Total Taxes	\$869k	\$418

*Both
Deaths
In 2009

#2 Credit Shelter Funding-\$5M

Credit Shelter Trust– (1 st to Die)	Option #1 \$2M	Option #2 \$3.5M
Marital Share to Surviving Spouse	\$3M	\$1.5M
IL Taxes - 1 st to Die	\$0	\$209k
Federal & IL Taxes – 2 nd to Die	<u>\$167k</u>	<u>\$0</u>
Total Taxes	\$167k	\$209

*Both
Deaths
In 2009

#3 Credit Shelter Funding-\$3.5M

Credit Shelter Trust– (1 st to Die)	Option #1 \$2M	Option #2 \$3.5M
Marital Share to Surviving Spouse	\$1.5M	\$0
IL Taxes - 1 st to Die	\$0	\$209k
Federal & IL Taxes – 2 nd to Die	<u>\$0</u>	<u>\$0</u>
Total Taxes	\$0	\$209k

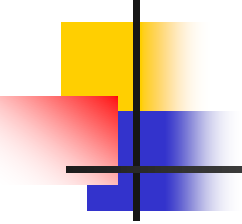
*Both
Deaths
In 2009



Critical Variables

Credit Shelter Trust Funding

- Anticipated size of Estate?
- What will be left at Surviving Spouse's Death?
 - Appreciation of Assets;
 - Consumption & Gifting by spouse
- WHERE will Surviving spouse Live at his or her death (i.e., IL or FL?)



The 2009 Malpractice Trap – Old “A/B” Trusts

- Many “A/B Trusts” prior to 2001 Tax Act
 - Funding Language: Marital Trust funded “smallest amount” to reduce Federal Estate Taxes to \$0
- Family Trust automatically Funded at \$3.5M
 - Generating \$209k of IL estate taxes in 2009
 - Unnecessary payment of taxes for smaller estates?
- Malpractice not to Revise such Trusts?



2009 Planning Techniques

- Marital Trust funded at “smallest amount” to reduce Federal & State Estate Taxes to \$0
 - Results in \$2M Credit Shelter Trust
 - **MAY** fund \$3.5M Credit Shelter Trust through Disclaimer or “Partial QTIP” election
- Disclaimer Trusts
- Single Fund QTIP Trust
- Gifting Strategies
 - Intervivos “Credit Shelter” Gifts to avoid Illinois Estate Taxes



Pending IL Legislative Solutions?

- Illinois "QTIP" Election
 - \$1.5M Differential held in Marital Trust subject to IL estate taxes upon 2nd to Die
- IL Estate Tax Exclusion Amount Increased to \$3.5M in 2009



2009 Estate Tax Rates

<u>Taxable Estate</u>	<u>Federal Tax</u>	<u>IL Tax</u>	<u>Tax Rate over \$2M</u>	<u>Tax Rate over \$3.5M</u>
\$2M	\$0	\$0	N/A	N/A
\$3.5M	\$0	\$209k	13.9%	N/A
\$5M	\$517k	\$352k	29%	57.9%
\$10M	\$2.5M	\$927k	42.9%	52.84%
\$20M	\$6.4M	\$2.3M	48.27%	52.66%



OTHER POSSIBLE CHANGES TO THE LAW

- Estate Tax Portability
- Limitations on Dynasty Trusts
- Limitations on Valuation Discounts
- Curtail Crummey Powers



Estate Tax Portability -

A Revolution in Planning!

- Classical Estate Planning
 - Separate Trusts for both Spouses to Utilize Both Estate Tax Exclusion Amounts
 - If Assets go to Surviving Spouse, Estate Tax Exclusion of 1st to Die may be “Wasted”
- Portability = Surviving Spouse Uses 1st to Die’s “Wasted” Estate Tax Exclusion



"Classical" Estate Planning

(Presume both deaths 2009)

Husband
Dies 1st

Wife
Dies 2nd

ASSETS (\$7M)

\$3,500,000

\$3,500,000

EXCLUSION AMT

(\$3,500,000)

(\$3,500,000)

NET ESTATE

\$0

\$0

ESTATE TAX

\$0

\$0

Both \$3.5M Estate Tax Exclusion Amts are Utilized.



“Portability” Estate Planning

(Presume both deaths 2009)

Husband
Dies 1st

Wife
Dies 2nd

ASSETS (\$7M)

\$All to Wife

\$7,000,000

Husband's Exclusion

\$0

(\$3,500,000)

Wife's Exclusion

\$0

(\$3,500,000)

FEDERAL ESTATE TAX

\$0

\$0

**Both \$3.5M Estate Tax Exclusion Amt's are Utilized
Even though Assets Have Not Been Split**



Implementation of Portability

- Increased Estate Tax Reporting?
 - Portability Only Applies to Marital Gifts
- Less Need for “Estate Tax” Planning?
- Still Need to “Split-Up” Trusts?
 - State Tax Decoupling
 - Larger Estates: Appreciation in Credit Shelter Trust Escapes the Estate Tax Base



Limit Dynasty Trusts

- Many States (IL Included) Repealed or Allow “Opt Out” from Rule Against Perpetuities
- Dynasty Trust Assets (after GST allocation) may grow for a potentially unlimited period of time without Estate Taxes
- Viewed by Joint Committee on Taxation as Abusive Needing Statutory Change prohibiting allocation of GST Exemptions to such trusts



Limit Valuation Discounts

- Family Limited Partnerships
 - 20-45% Minority & Marketability Discounts
 - Recent cases generally favorable to IRS
- Joint Committee on Taxation views Current Rules as Abusive Needing Change
 - Aggregation Rules (FMV Gift based on Interests owned by Donor...limits Minority Discounts)
 - Look-Through Rules (limits Marketability Discounts to extent entity holds marketable assets)



Curtail Crummey Powers

- Standard Technique to Greatly Multiple Annual Exclusion for Gifts to Trusts
 - Problem: Crummey Holders may not be “Vested”
- Viewed by Joint Committee on Taxation as Abusive Needing Statutory Change
 - Would require Donee to be Vested in Trust
 - Or, require determination there is a “meaningful possibility” Crummey Power would be exercised...

THE END!!!



- Thank You

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