BAKER DONELSON
BEARMAN, CALDWELL & BERKOWITZ, PC
EXPAND YOUR EXPECTATIONS™

TAX ALERT

December 29, 2010

Estate Planning Under a New Law

Estate planning has been altered significantly by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Act), signed on December 17, 2010. Under the Act, the federal estate, gift and generation-skipping transfer tax rates and exemptions are unified at 35 percent and $5 million, respectively, beginning in 2011. These and other substantial changes to such taxes from prior law will remain effective through 2012 unless an extension is enacted by Congress to continue such changes.

Our purpose in this Alert is to address certain planning issues under the new Act.

Simplification

The Act introduces the concept of portability to estate planning. In short, the estate of a surviving spouse, if all qualifying rules are met, can now use not only that individual's exemption against the federal estate tax, but also the unused exemption of the most recent predeceased spouse dying after December 31, 2010. The Act increased the amount of the estate tax exemption to $5 million and thus, with proper use of this portability feature, will allow a couple to pass $10 million to their successors free of federal estate tax. (There still may be a state estate or inheritance tax depending on applicable state laws).

Much time and effort in the past have been used to create various planning techniques designed to maximize both spouses' exemptions before the concept of portability. Many of you will recognize discussions concerning A/B trusts, marital deduction/exemption trusts, and QTIP trusts as examples of the complex tools used to preserve both exemptions. For married couples with combined estates under $10 million, these complexities may no longer be necessary with the Act's portability and $5 million exemption for each spouse. While each person's or couple's estate plan must be constructed only after full review of their desires, the capacity of their successors and numerous other factors, in the right circumstances far simpler wills may now accomplish those purposes and still provide efficient tax planning.

This potential for simplification, however, must also take into account the currently scheduled sunset of the portability and other estate planning related provisions of the Act at the end of 2012. Thus, because of the short duration of these provisions (at least without Congressional extension beyond 2012), what initially seems like simplification could very well require keeping some amended versions of the existing planning techniques referenced above. Such a determination must obviously be made based on the particular facts and circumstances.

Unintended Consequences

There are several undesirable consequences which unintentionally may result from applying the provisions of the new Act to existing estate planning documents that were prepared under prior law. For example, and as discussed in our January 15, 2010 Tax Alert, many estate plans divide estates into exemption portions and

Continued

marital portions to meet the rules necessary to preserve both exemptions. Now that the Act has increased an individual's exemption to $5 million, a far greater share of the deceased's estate governed by the Act may inadvertently be going to the children, leaving the spouse with much less under wills prepared based on prior law.

Likewise, the exemption against the generation-skipping transfer tax has also been increased by the Act to $5 million, but does not have the same portability feature as the estate tax. Such increase may cause present documents to leave far more to the grandchildren than was ever intended. These and other unintended consequences may have the effect of partially or completely destroying the real objectives within your current planning documents.

These and other unintended consequences may have the effect of partially or completely destroying the real objectives within your current planning documents.

Unwinding Current Plans

The higher exemptions provided under the Act may also present opportunities to change, or unwind some prior plans and structures. Insurance trusts have often been formed in the past as a means for holding life insurance on an individual or both spouses in order to not only meet liquidity needs for paying federal estate taxes, but also to keep those proceeds out of the taxable estates of the insureds. These trusts should be currently reviewed. If, after careful consideration, such trusts are determined to be no longer necessary, the Uniform Trust Code (which is applicable in many of the resident states of our clients) may offer opportunities to change or terminate these structures that are unnecessary in some circumstances.

In addition, various family entities (family limited partnerships, limited liability companies, etc.) may have also been formed in the past in order to provide various advantages under prior estate tax law. While there are numerous non-tax reasons and advantages to use and keep such entities in place, individuals should consult with their planners to determine whether or not such entities are still necessary or even may produce adverse tax consequences in view of the Act.

Gift Taxes

Please note that there is a very limited opportunity in 2010 only, as pointed out in our December 22, 2010 Tax Alert, to make unlimited gifts to grandchildren free of generation-skipping transfer tax though gift tax would generally apply to gifts beyond the 2010 gift tax exemption of $1 million.

During 2011, while the annual exclusion against the gift tax will not change, the lifetime exclusion an individual has against the gift tax will increase to $5 million. While any use of this lifetime exclusion generally offsets the amount otherwise available at death against the estate tax, this greatly increases the opportunity to pass substantial property, its subsequent income and appreciation, to others free of federal gift, estate, and generation-skipping transfer taxes.

Continued

Recommended Action

We recommend that individuals consult now with their planners to discuss opportunities under the new Act, and, equally important, to address any unintended consequences of or structures no longer needed within their overall estate planning program. While the estate, gift and generation-skipping tax provisions under the Act are presently scheduled to sunset at the end of 2012, we recommend that estate and financial planning objectives should nevertheless be reviewed and guided by the Act's provisions, as well as anticipated future possibilities, rather than hoping that prior law (under which most existing estate planning documents have been prepared) will somehow be revived by Congress at some point in the future.

Should you have any questions or wish to address any aspects of your current estate or financial plan, please contact any of the following attorneys within the Firm's Tax Department:

Atlanta, Georgia

Nedom A. Haley	404.221.6505	nhaley@bakerdonelson.com
Michael S. Evans	404.221.6517	mevans@bakerdonelson.com
Roslyn I. Dodell	404.223.2211	rdodell@bakerdonelson.com

New Orleans, Louisiana

Robert W. Nuzum	504.566.5209	rnuzum@bakerdonelson.com

Baton Rouge, Louisiana

Alton "Biff" Bayard III	225.381.7019	abayard@bakerdonelson.com

Birmingham, Alabama

Robert T. Gardner	205.250.8373	rgardner@bakerdonelson.com
Anne W. Mitchell	205.250.8308	amitchell@bakerdonelson.com
Andrew J. Potts	205.250.8325	apotts@bakerdonelson.com
Linda S. Lehe	205.250.8362	llehe@bakerdonelson.com

Continued

Estate Planning Under a New Law, *continued*

Nashville, Tennessee

Richard D. Bird	615.726.7327	rbird@bakerdonelson.com
Carolyn W. Schott	615.726.7312	cschott@bakerdonelson.com
John B. Burns	615.726.5599	jburns@bakerdonelson.com

Knoxville, Tennessee

Angelia M. Nystrom	865.971.5170	anystrom@bakerdonelson.com
Kenlyn Christina Foster-Spence	865.971.5108	kfoster@bakerdonelson.com

Memphis, Tennessee

William H.D. Fones Jr.	901.577.2247	wfones@bakerdonelson.com
Adam C. Flock	901.577.8167	aflock@bakerdonelson.com

East Memphis, Tennessee

James R. "Josh" Hall Jr.	901.579.3126	joshhall@bakerdonelson.com
Christopher J. Coats	901.579.3127	ccoats@bakerdonelson.com

Chattanooga, Tennessee

Virginia C. Love	423.209.4118	vlove@bakerdonelson.com
Philip B. Whitaker	423.209.4182	pwhitaker@bakerdonelson.com
William E. Robinson	423.209.4107	wrobinson@bakerdonelson.com

Continued

Estate Planning Under a New Law, *continued*

Jackson, Mississippi

James K. Dossett Jr.	601.351.2482	jdossett@bakerdonelson.com
David P. Webb	601.969.4678	dwebb@bakerdonelson.com
Leonard C. Martin	601.351.2453	lmartin@bakerdonelson.com
D. Nathan Smith	601.969.4682	dnsmith@bakerdonelson.com

Washington, D.C.

Scott D. Smith	202.508.3430	sdsmith@bakerdonelson.com