PUBLICATION

2011 Fall Estate Planning Alert

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The federal estate and gift tax exemption is $5,000,000 in 2011, and is currently anticipated to be $5,120,000 through the end of 2012. With these significant opportunities, enacted through the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act (Tax Relief Act of 2010) signed by the President in December 2010, some might think that tax planners and preparers presently have little to do in the area of estate planning and estate tax returns. To the contrary, these opportunities can easily be lost by missing important upcoming deadlines.

This Alert covers time-sensitive actions that must be taken in order to take advantage of, or preserve, these transfer tax saving opportunities.

Taking Advantage of Gifting Opportunities

As noted in our April 14, 2011 Estate Planning Alert, Gifting: A Temporary Window of Opportunity, the 2011 and 2012 years represent an unparalleled opportunity for taxpayers to make large gifts free of gift and generation-skipping transfer (GST) tax. The Tax Relief Act of 2010 is scheduled to sunset at the end of 2012 and, as a result, this temporary window is closing fast. Unless Congress takes action, after December 31, 2012, the exemption amount for estate, gift and GST tax will revert to $1,000,000.

Why should taxpayers consult their tax planning attorneys prior to making large gifts? There are many reasons to consult your tax planning attorney on how to structure large gifts, but here are some especially urgent issues to keep in mind:

- The $13,000 annual exclusion is in addition to the lifetime gift and GST tax exemption available to taxpayers. Taxpayers should consult their estate planning attorneys on how best to take advantage of not only their lifetime exemption, but also the annual exclusion.
- Some clients want to make large gifts to children and/or grandchildren. Your attorney can help you establish a trust that will provide for your children and grandchildren, potentially for generations to come. A trust may also be structured to protect the gifted funds from the creditors of beneficiaries.
- Although the federal gift tax exemption is $5,000,000 for 2011 and $5,120,000 for 2012, some states (such as Tennessee) impose a gift tax and do not have a similar lifetime gift tax credit available. Without proper advice, clients may unwittingly make a gift with state tax consequences
- The year-end marks a time when many consider making gifts not only to individuals, but also to charities. However, as noted in our recent July 6, 2011 Spotlight On Exempt Organizations: Reinstating Exempt Status, the Internal Revenue Service revoked the tax-exempt status of over 275,000 organizations this year as a result of new, more stringent filing requirements. Donors cannot take charitable deductions for donations made to an organization that has had its tax-exempt status revoked; and in 2011, more so than any other time, there is a very real risk of charitable deductions being denied.
- In addition to making gifts to children or grandchildren, there are other more sophisticated estate planning measures that a client can utilize with the increased gift tax exemption. For example, a client possibly may use the increased exemption as "seed" money to fund an intentionally defective grantor

trust, to fund a life insurance trust, or place their home or vacation property in a qualified personal residence trust.

Making Sure Your Estate Plan Is Up-to-Date

The end of the year is an excellent time to take a look at your existing estate plan and make sure that it is still in line with your intentions. For example, due to the ever-changing landscape of federal transfer tax statutes, some states have a so-called "Gap" problem, where the state inheritance tax exemption is significantly smaller than the federal estate tax exemption. If your current estate plan documents do not take this into account, your spouse may end up footing a bill for state inheritance tax before it is necessary to do so.

In our August 3, 2011 Alert Does Your Estate Plan Still Fit Your Estate?, we addressed the many non-tax reasons for updating your estate plan. The holidays are all about family, and if you have had a major change in your family since the last time you updated your estate plan (for example, a marriage, divorce, or the birth of a child or grandchild), make sure you take a hard look at your existing plan documents to ensure that your objectives are still being considered correctly.

Making the Section 1022 Election for Decedents Who Died in 2010

Under the Tax Relief Act of 2010, the executor of an estate of a decedent who died in 2010 can opt out of the estate tax and elect under Internal Revenue Code Section 1022 to apply modified carryover basis treatment to property acquired from the decedent (Section 1022 Election). If the Section 1022 Election is made, the estate will not be subject to federal estate tax and does not need to file an Estate Tax Return (IRS Form 706) even if the value of the estate is $5,000,000 or more.

How does the Section 1022 Election affect basis in property acquired from a decedent? When the Section 1022 Election for modified carryover basis treatment is made, Code Section 1014 -- which otherwise provides a step-up in basis for assets -- generally does not apply to determine the recipient's basis in property acquired at death. Instead, Section 1022 applies to determine the recipient's basis in most (but not all) property acquired from the decedent. The election allows the executor to adjust basis in eligible property up to that property's fair market value. However, unlike under Section 1014, the basis increase allowed under the Section 1022 Election is capped by both the property's fair market value and by dollar amounts provided by the statute.

Section 1022 also allows an executor to allocate a general basis increase of up to $1,300,000 to "eligible property." Eligible property is property acquired from the decedent that was owned by the decedent at the time of death. The executor may also allocate up to $3,000,000 basis increase to "eligible" spousal property under Section 1022.

How does an executor make a Section 1022 Election and when must the Election be made? An executor can make a Section 1022 Election by timely filing IRS Form 8939. The due date for Form 8939 has changed several times, but the Internal Revenue Service's recently issued instructions to Form 8939 provide that Form 8939 is due January 17, 2012. The Service has indicated that no extensions of time will be granted, though some limited relief provisions are provided in Notice 2011-66.

Is it possible to "default" into a Section 1022 Election? Although it is termed an Election, tax preparers should note that if a Form 706 or an extension for that Form has not been timely filed, the estate has made the Section 1022 Election by default. Additionally, once made, the Section 1022 Election is irrevocable.

Preserving Portability by Filing an Estate Tax Return

Executors for estates of decedents dying after December 31, 2010 have an opportunity to take advantage of a new concept in the estate planning world -- portability. Portability preserves the unused estate tax exemption of a decedent dying after December 31, 2010 for the decedent's surviving spouse. However, the Service recently made clear in Notice 2011-82 that portability is considered an election. In order to preserve portability for a decedent's surviving spouse, the executor must file a Form 706, even if the executor is not otherwise required to file a Form 706. While the Service has indicated that it will issue regulations addressing the many issues posed by portability, until such regulations are issued, the Internal Revenue Service has indicated that taxpayers should assume that the regulations will be consistent with Notice 2011-82.

Unless portability is made permanent, portability may have a very limited application, since it is only available to certain estates of surviving spouses who die before January 1, 2013 and whose predeceased spouse died after December 31, 2010. Further, many traditional estate planning avenues offer advantages not available with portability. As a result, some traditional estate planning avenues may be preferred over reliance upon portability.

Pending Recommendations of the Congressional Super Committee

In our August 5, 2011 Tax Alert, The Budget Control Act of 2011 - Tax Considerations, we discussed that the Budget Control Act of 2011 called for the establishment of a Joint Select Committee on Deficit Reduction (generally referred to as the "Super Committee"). The Super Committee is a bipartisan committee of 12 members – six members from the House and six members from the Senate – charged with the task of producing legislation by November 23 of this year that will trim the deficit by $1.2 trillion over the next ten years. In light of this impending deadline, there is uncertainty at the moment as to whether the estate and gift tax exemption will be the full anticipated $5,120,000 through the end of 2012, as some deficit reduction proposals are rumored to require a reduction in this exemption. Although not currently substantiated, one change rumored to be included in the Super Committee's proposals is to make November 23, 2011 the date upon which the exemptions revert to as low as $1 million. If this change is included in the Super Committee's proposals and enacted into law, those who have not used their $5 million exemption by that date would lose the opportunity to do so.

Summary

Thoughtful estate planning is required now more than ever as we continue to face uncertainties, both economically and in Congress. Financial concerns for many future generations are all but assured without the assistance of a prudent estate plan implemented now. Opportunities currently offered by the Tax Relief Act of 2010 could very possibly evaporate or be limited sooner than anticipated depending on the Super Committee's recommendations. The time to address your estate plan is now.

Should you have questions or otherwise wish to discuss your particular planning needs or objectives, please contact one of the attorneys in the Firm's Tax Department.