

Recent Estate Planning



Developments



& Newsletter

Summer 2012

by Shaftel Law Offices, P.C.
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Estate Planning in 2012

IS THE TRAIN GETTING READY TO LEAVE THE STATION?



We are all familiar with the old metaphor of “the train is getting ready to leave the station.” That is, if we want to take advantage of being on this train, we better get on it or we will be left behind watching it disappear down the track.

This may be the situation with respect to the window of opportunity that exists for estate planning during the remainder of 2012.

**2012
may be a
“window of
opportunity”
that will be
closed**

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THE 2012 GIFT, ESTATE AND GST LAW IS VERY FAVORABLE.

For clients with a net worth of more than \$2,000,000, a number of very favorable estate planning techniques exist.

Applicable Exclusion. During 2012, each of us has a \$5,120,000 applicable exclusion amount. This means that each of us can transfer a total of \$5,120,000 without being subject to the federal estate tax. Further, and brand new, we can use up to all of this exclusion amount during our lifetime for tax-free gifts.

GST Exclusion. Similarly during 2012, each of us has \$5,120,000 of federal generation-skipping transfer tax exemption. This means that we can protect from the generation-skipping transfer tax \$5,120,000 worth of assets transferred outright or in trust to grandchildren or further generations.

Tax Rate. During 2012, the tax rate on gifts or estates that exceed the applicable exclusion amount is 35%. This is quite low compared to the 55% rate (60% in certain situations) that we have seen in the past.

Perpetual Trust. Under Alaska law, which is recognized by the Internal Revenue Service, trusts can continue perpetually. As a result, assets which are gifted and sold to trusts, and protected by GST exemption, can avoid future federal gift, estate, and GST taxes forever. Use of a perpetual trust plan can provide asset protection and tax benefits not only to the grantor and the grantor's spouse but also to children, grandchildren, great-grandchildren, and further generations.

Valuation Discount. Interests in limited partnerships, limited liability companies, closely held corporations, fractional interests in real property, and similar interests, often qualify for discounts in value due to lack of control, lack of marketability, and various features of the business entity involved. Such discounts often are between 20% to 40%. These discounts can in turn be used with respect to transfers among family members or to family trusts.

Grantor Trust. A trust can be structured so that for income tax purposes it is ignored and all of its income is taxed to the grantor (the person who formed the trust). This can be very advantageous for estate planning purposes. Assets can be gifted to a grantor trust, often at a reduced value due

to the valuation discount discussed above. Those assets, their future appreciation, and the income produced by those assets will all be excluded from the donor's gross estate at death. Further, if the trust is a grantor trust, the grantor can pay all of the income tax resulting from these assets, and this is an additional way for the grantor to make tax-free gifts.

Similarly, the grantor can sell assets to a grantor trust. Because the trust is ignored for income tax purposes, there is no capital gain on the sale transaction. When the sale is structured on the installment basis, interest payments are not interest income to the grantor. Again, the assets, their appreciation and income will all be excluded from the grantor's gross estate at death.

GRAT. This is an excellent way to exclude future growth and income from assets from the grantor's gross estate. A "zeroed-out GRAT" is one where the grantor transfers assets to the trust and the trustee is obligated to make annual payments back to the grantor equal to the value of the property transferred plus the current applicable federal interest rate. In 2012, interest rates are extremely low. Therefore,

In 2012,
each person
can gift
\$5,120,000
free of
Federal
Gift Tax

a person can transfer assets which are expected to appreciate or produce income in the future. As long as the appreciation and income is greater than the present very low interest rates, the difference will be excluded from the grantor's gross estate. Again, available valuation discount makes this planning approach more powerful.

Use a DAPT. Alaska law allows a grantor to create a self-settled discretionary spendthrift trust, commonly called a DAPT. This type of trust allows a person to form an irrevocable trust, gift, sell, or otherwise transfer assets to the trust, and be a discretionary beneficiary of that trust. Present law indicates that the trust assets will not be included in the grantor's gross estate for federal estate tax purposes. The assets in the trust are protected from the grantor's creditors. When use of a DAPT is combined with the 2012 gifting and other approaches described above, a grantor can transfer a very substantial amount of assets to a trust and still have those assets available to the grantor if needed in the future.

SUNSETTING



At the end of 2012, the train has left the station and our metaphor changes to one of the sun setting on the horizon. Darkness will quickly follow.

To understand sunsetting, we have to take a quick journey into the past. In 2011, the Bush Administration and Congress attempted to repeal the estate and generation-skipping transfer (GST) taxes. However, they did not have enough votes (60 in the Senate) to make the repeal permanent. The result was that the 2001 Tax Act could only last for ten years and then it would "sunset" (go away), and the prior law would come back into effect. During the ten-year period, Congress and the Administration failed to come up with a permanent solution to the federal gift, estate, and GST taxes. During December of 2010, the Administration and Congress in a way "punted" and agreed to extend the ten-year period

for two additional years, 2011 and 2012. During those years, we were provided the favorable applicable exclusion amount, GST exemption amount, and tax rate, as discussed above. The "transfer tax sun" has remained above the horizon for two more years but is again scheduled to disappear at the end of 2012. At that time, instantaneously the transfer tax law will go back to the law that would have been in effect had the 2001 Tax Act never been enacted. The consequences will be as follows:

Applicable Exclusion. Under pre-2001 law, the applicable exclusion was scheduled to increase to \$1,000,000 by 2006. That will be the applicable exclusion in 2013. It may be used for either gifting during lifetime or to protect transfers at death. This means that a single person will have only \$1,000,000 of tax-free transfers, and married couple will have \$2,000,000.

GST Exemption. The generation-skipping tax exemption generally tracks the \$1,000,000 applicable exclusion, but it is subject to an inflation adjustment. Therefore, the 2013 GST exemption will be approximately \$1,400,000.

Tax Rate. Prior to the 2001 Tax Act, the maximum tax rate was 55% plus a 5% surcharge on the amount of a taxable estate between \$10,000,000 and \$17,200,000. Therefore, the maximum rate will be 55%, and for some taxpayers it will be 60% for a portion of their assets.

Planning Techniques. If sunsetting occurs, and no further legislation is enacted, then we will continue to have the availability of the perpetual trust, valuation discount, sales to grantor trusts, and flexible terms for GRATs.



WILL THERE BE A NEW LAW — WHAT CAN WE EXPECT?

Treasury's Proposals. In February 2012, the Department of Treasury issued its General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals. The estate and gift tax proposals include the following:

Applicable Exclusion and GST Exemption. The Administration proposes that both of these amounts be \$3,500,000, the same as the amount that applied during 2009.

Gift Tax Exclusion Amount. However, only \$1,000,000 of the above \$3,500,000 could be used during lifetime as tax-free gifts. This is dramatically different from the \$5,120,000 amount allowed during 2012.

Tax Rate. The top tax rate would be 45% as compared to the 2012 top rate of 35%.

Perpetual Trust. The generation-skipping transfer tax exempt status of a trust, resulting from an allocation of GST exemption to the trust, would only last for 90 years. After that time, the trust would not be exempt from generation-skipping transfers in the future. That is, if distributions then were made to grandchildren or further generations, those distributions would be taxable. The GST tax rate is the same as the maximum estate tax rate (45%).

Valuation Discount. Transfers of interests in a family-controlled entity such as a limited partnership, limited liability company, or closely held corporation, to a member of the family will no longer qualify for valuation discount. As stated above, these discounts often run in the 20% to 40% range.

Grantor Trust. This proposal provides that if a trust is a grantor trust, then the assets in the trust would be included in the grantor's estate at death for estate tax purposes. Further, distributions from the trust

during the grantor's lifetime would be treated as taxable gifts by the grantor. Also, if the grantor trust status ends then all of the assets in the trust will be treated as a gift by the grantor. This proposal is designed to end all of the estate planning advantages of grantor trusts as discussed above.

GRAT. This proposal requires that a GRAT have a minimum duration of ten years. In order to get the benefits of a GRAT, the grantor has to live during the entire fixed term of the GRAT. For this reason, many GRATs have been designed to last relatively short periods of time; for example,

two years or five years. By requiring that a GRAT last for at least ten years, the Treasury Department is creating more of a risk that the grantor will die during the fixed term of the GRAT, and therefore will not achieve the exclusion of the GRAT's remaining assets from the Federal Estate Tax.

Effective Date. The Treasury Department's proposals, if enacted, would be effective for transfers made after 2012. Therefore, planning during the remainder of this year would not be affected.

Surprises. The above proposals are not limitations on what a new law might contain. Often there are unpublished and undiscussed changes that emerge from Congress' conference rooms at the last minute.

WHEN WILL CHANGES OCCUR?

Most commentators have concluded that nothing will occur prior to the November 2012 elections. Both parties are too involved in the election process,

**Treasury
Department
proposals
would limit
or eliminate
existing
planning
techniques**

and the subject of taxes is an issue which each party is attempting to use to attract voters. The results of the election will of course be very important. If either party has both the Administration and both houses of Congress, and 60 votes in the Senate, then that party can design and enact its own plan. However, absent one of those elements, a compromise will be needed. It could occur during the lame duck session (latter part of November and into December). Many commentators think that it is more likely that a compromise, if one is reached, will occur sometime in 2013. The new legislation would then be retroactive to January 2013. If a compromise cannot be reached, then we will have gridlock with reversion to the pre-2001 law, as described above.

SOME OF THE POSSIBILITIES.

Depending on which party wins the presidency, and controls the House, Senate, and 60 votes in the Senate, we could see one of the following possible alternatives:

Sunsetting. The Democrats have been focusing on the “one percent” and the need to raise revenue through increased taxes. They have argued that tax cuts favoring the wealthy should be allowed to sunset. If this happens, we will have a \$1,000,000 exclusion amount, \$1,000,000 GST exemption amount, and a 55% rate.

Repeal. The Republicans have long sought repeal of these transfer taxes. If they obtain control of all three branches of government, and 60 votes in the Senate, the time for repeal might come.

Compromise. Regardless of which party wins the Executive Branch, Congress may be closely split. This might well lead to a negotiated compromise. Some commentators have suggested that in exchange for a large estate tax exclusion amount, and lower tax rate, the compromise may include the enactment of the Treasury Department’s proposals to limit tax-free gifts to \$1,000,000, prohibit tax benefits for perpetual trusts, end valuation discount, end all of the tax advantages for grantor trusts, and require that

GRATs be long term. This will severely curtail estate tax planning for larger estates.

Extension. The parties may decide to “kick the can down the road,” and agree on another extension of the 2001 Tax Act; perhaps for one year.

WHAT SHOULD YOU DO IN 2012?

As described above, 2012 is a particularly advantageous time to accomplish estate planning which will reduce future estate taxes. Absent complete repeal of these taxes, which appears very doubtful, the tax law after 2012 will very probably not be as attractive as it is in 2012. During the remainder of 2012, each person has a \$5,120,000 applicable exclusion amount, a \$5,120,000 GST exemption amount, can qualify transfers to perpetual trusts for as long as the trusts have assets, can take advantage of valuation discount, can make income tax free sales to grantor trusts, and can create short-term GRATs.

REVIEW YOUR PLANNING.

We highly recommend that you review your estate planning situation in light of the above-described expected changes in the tax law. We are available to meet with you and help evaluate your situation and offer assistance with the above types of planning. This is not the type of planning that can wait until the last minute. If you decide to take advantage of some of the techniques described above, your estate planners will need time to implement your project before year-end.

**Will there be
Sunset?
Repeal?
Compromise?
Extension?**

Our Office Estate Planning Presentations

Clients and professionals have contacted us and requested presentations that illustrate estate planning and related subjects such as business succession planning. As a result, we have a program of offering presentations periodically in our office conference room. Presentations are scheduled for late afternoon and usually last for an hour and a half. One of our attorneys will narrate a PowerPoint presentation for approximately 45 minutes and then we have approximately 45 minutes of discussion and questions. These sessions have been very popular.

You are invited to attend one of these sessions if you would like a refresher in estate planning, and more information about planning in 2012. Please consider recommending them to your family and friends. If you are a professional, we are happy to host you and your clients for a presentation. Of course, there is no charge or obligation connected with these presentations. We hope that you will find them useful, and we hope that you will consider us in the future for your estate planning needs.

If you are interested, please call our office (276-6015) to find out the date of the next presentation.

www.shaftellaw.com

You may refer to our website for a variety of information:

Updates on Congress' actions changing federal gift, estate and generation-skipping transfer taxes;

- A "what's new" discussion of developing estate planning subjects;
- New state legislation affecting estate planning;
- A "checklist" for evaluation of your estate planning;
- Discussion of a number of relevant estate planning techniques;
- Our past newsletters;
- Key Alaska estate planning statutes; and
- Many articles which we have written about Alaska estate planning techniques.

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