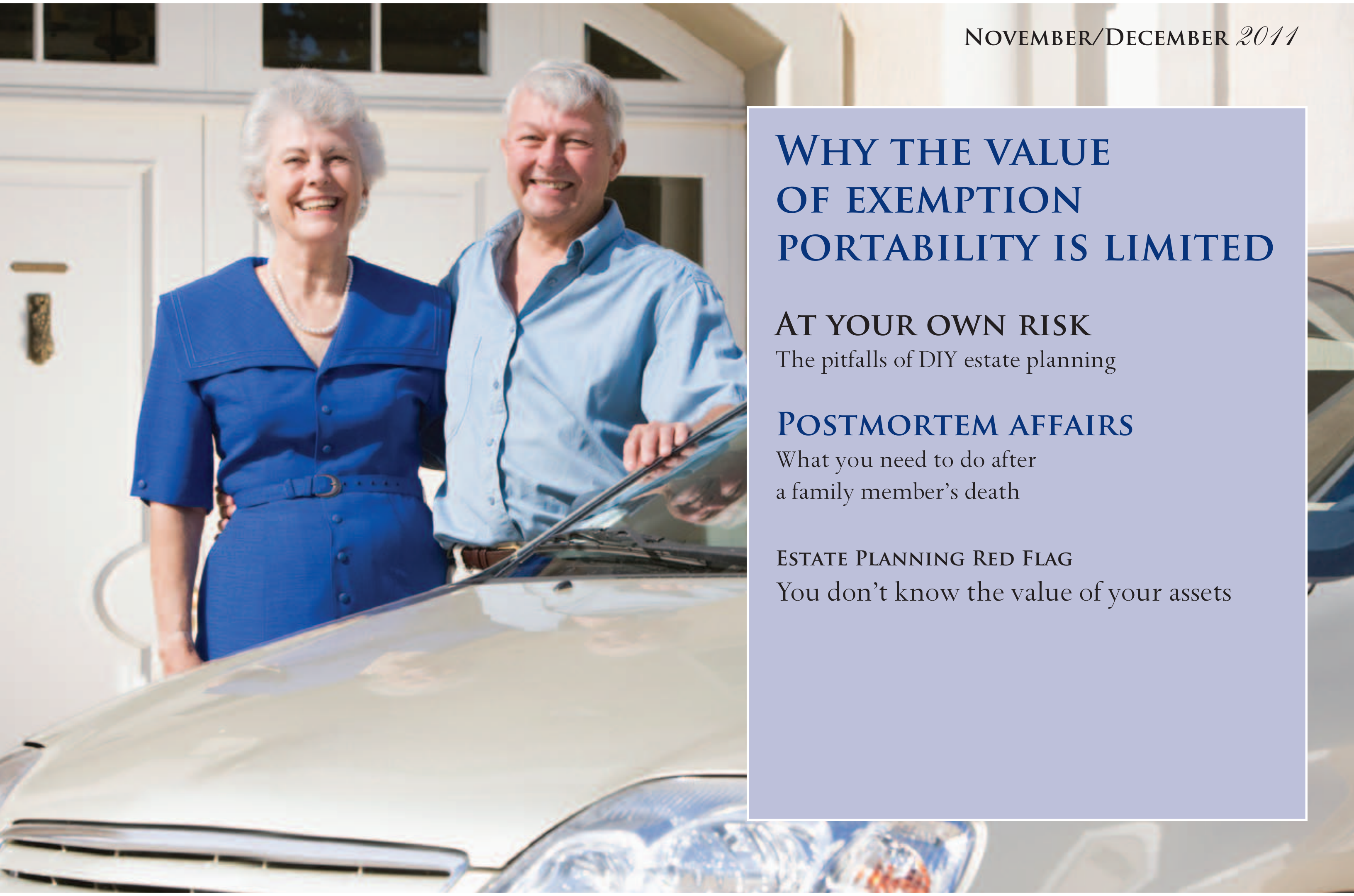
The Estate Planner



November/December 2011

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What you need to do after a family member's death

Estate Planning Red Flag
You don't know the value of your assets

Shumaker

Shumaker, Loop & Kendrick, LLP

Charlotte
First Citizens Bank Plaza
128 South Tryon Street
Suite 1800
Charlotte, North Carolina
28202-5013
704.375.0057

Columbus
Huntington Center
41 South High Street
Suite 2400
Columbus, Ohio
43215-6104
614.463.9441

Sarasota
240 South Pineapple Ave.
10th Floor
Sarasota, Florida
34236-6717
941.366.6660

Tampa
Bank of America Plaza
101 East Kennedy Blvd.
Suite 2800
Tampa, Florida
33602-5151
813.229.7600

Toledo
North Courthouse Square
1000 Jackson Street
Toledo, Ohio
43604-5573
419.241.9000

Why the value of exemption portability is limited

One notable change to estate tax law from last year's Tax Relief act is the "portability" of gift and estate tax exemptions. For the first time, when one spouse dies, the surviving spouse can take advantage of the deceased spouse's unused exemption.

The objective of portability is laudable — namely, to allow married couples to take advantage of their combined exemptions without the need for complex estate planning strategies. But on closer inspection, its value is limited.

Use it or lose it

Before portability, married couples who wished to take full advantage of both spouses' exemptions had to "use it or lose it." Each spouse had to have enough assets in his or her name to make use of the exemption. If one spouse owned most or all of the couple's wealth and the "nonowner" spouse died first, the latter's exemption amount would be wasted.

Also, each spouse's estate plan had to be designed to avoid taxation of otherwise exempt amounts in the surviving spouse's estate. Suppose, for example, that each spouse owned $5 million in assets and their wills provided for those assets to pass to the survivor.

The transfer would be tax exempt under the unlimited marital deduction (provided each spouse was a U.S. citizen), but the assets eventually would be taxed in the survivor's estate. Assuming the survivor had $10 million in assets at death and the exemption hadn't changed, $5 million would be subject to estate tax. Again, the first spouse's exemption would be wasted.

Traditionally, the solution to the first problem has been to equalize the spouses' estates by transferring assets from owner to nonowner. And the most common solution to the second problem has been for each spouse to establish a credit shelter (or bypass) trust.

Generally, credit shelter trusts are funded with the maximum amount that can be sheltered from tax by the deceased spouse's exemption. The trust pays income to the surviving spouse for his or her life and subsequently distributes the remaining assets to the couple's children or other beneficiaries.

Because the surviving spouse never gains control, the trust assets bypass his or her estate. In the previous example, the use of a credit shelter trust would have avoided estate taxes altogether. The first spouse's $5 million exemption amount would pass into the trust. Then, when the surviving spouse dies, his or her exemption would cover the remaining $5 million. In such a case, neither spouse's exemption would be wasted.

A limited solution

Portability seems to offer a simple solution, allowing couples to make the most of their exemptions without transferring assets or establishing complicated trusts. In most cases, however, it's no substitute for traditional estate planning. Here's why:

It's temporary. Relying on portability is risky because, unless Congress intervenes, it won't be available after 2012. Even if one spouse dies before portability's expiration, the surviving spouse must die or use up the deceased spouse's exemption via lifetime gifts before portability expires, or the exemption will be lost.

Relying on portability is risky because, unless Congress intervenes, it won't be available after 2012.

It doesn't protect your assets. Even if Congress extends portability, it won't protect your assets from your spouse's creditors, nor will it guarantee that he or she will manage the funds wisely or ultimately pass them on to your children. A credit shelter trust offers creditor protection, management oversight by a trustee you select and assurances that your wealth will ultimately benefit your children.

Portability isn't automatic

If you decide to take advantage of portability, be aware that it doesn't apply automatically. A surviving spouse can take advantage of portability only if the deceased spouse's executor makes an election on a timely filed estate tax return. This is the case even if a return wouldn't otherwise be required.

Generally, estate tax returns are due within nine months of death, with an option to request a six-month extension.

It doesn't avoid taxes on appreciation. Unlike a credit shelter trust, portability doesn't lock in asset values for gift and estate tax purposes on your death, so appreciation can trigger unnecessary tax liability.

Suppose that you and your spouse each own $5 million in assets and that you leave your entire estate to your spouse. If you die in 2012 without having made any taxable gifts, portability allows your spouse to use your entire $5 million exemption. Let's say portability and the $5 million exemption are made permanent. If, when your spouse dies, the value of your assets has grown to $8 million, the $3 million of appreciation will generate $1.05 million in estate taxes (assuming a 35% rate and that your spouse's own $5 million exemption is being used to protect his or her original $5 million).

A credit shelter trust would have avoided estate taxes — in both your estate and your spouse's estate — on the entire $8 million. This is true regardless of whether portability is extended and even if the estate tax exemption has been reduced at the time of your spouse's death. (Note that assets in your spouse's name that are in excess of his or her own available exemption at death would still be subject to tax.)

That being said, portability does have one appreciation-related advantage: Unlike assets in a credit shelter trust, assets you've transferred to your spouse are entitled to a stepped-up basis when your spouse dies, reducing or eliminating capital gains taxes should your beneficiaries sell the assets. In most cases, however, the immediate estate tax savings produced by a credit shelter trust will outweigh the future additional income tax cost related to having a lower basis.

Portability doesn't lock in asset values for gift and estate tax purposes on your death.

It doesn't apply to generation-skipping transfer (GST) tax. The GST tax exemption isn't portable. If you wish to provide for your grandchildren, therefore, you'll need to use traditional estate planning techniques.

It may not be available for state estate tax purposes. If you rely on portability for federal tax purposes but live in a state that doesn't recognize it for state estate tax purposes, you'll forfeit any unused state exemption. (As of this writing, the states that have a separate estate tax system haven't adopted portability.)

If your spouse remarries, the benefit may be lost. Portability is available only for a person's most recently deceased spouse. If your spouse remarries and his or her second spouse dies, portability will be limited to the second spouse's unused exemption, even if there is little or nothing left of it.

Is portability right for you?

If you believe that Congress will maintain the current estate tax regime and that you and your spouse's combined estates won't grow beyond $10 million, portability might work for you. Under those circumstances, you can avoid gift and estate taxes and achieve a stepped-up basis for your children with minimal estate planning.

If you and your spouse have estates worth more than $10 million or if you aren't willing to take the risk that Congress will eliminate portability or reduce the estate tax exemption, traditional estate planning strategies may be your best bet. ✤

At your own risk

The pitfalls of DIY estate planning

There's no law that says you can't prepare your own estate plan. And with an abundance of online services that automate the creation of wills and other documents, it's easy to do. But unless your estate is small and your plan is exceedingly simple, the pitfalls of do-it-yourself (DIY) estate planning can be many.

Dotting the i's and crossing the t's

A common mistake people make with DIY estate planning is to neglect the formalities associated with the execution of wills and other documents. Rules vary from state to state regarding the number and type of witnesses who must attest to a will and what, specifically, they must attest to.

Also, states have different rules about interested parties (that is, beneficiaries) serving as witnesses to a will or trust. In many states, interested parties are ineligible to serve as witnesses. In others, an interested-party witness triggers an increase in the required number of witnesses (from two to three, for example).

Keeping abreast of tax law changes

Legislative developments during the last several years demonstrate how changes in the tax laws from one year to the next can have a dramatic impact on your estate planning strategies. DIY service providers don't offer legal or tax advice — and provide lengthy disclaimers to prove it. Thus, they cannot be expected to warn users that tax law changes may adversely affect their plans.

Consider this example: In 2003, Dave used an online service to generate estate planning documents. At the time, his estate was worth \$2 million and the federal estate tax exemption was \$1 million.

Dave's plan provided for the creation of a trust for the benefit of his children, funded with the maximum amount that could be transferred free of federal estate tax, with the remainder going to his wife, Ann. If Dave died in 2003, for example, \$1 million would have gone into the trust and the remaining \$1 million would have gone to Ann.

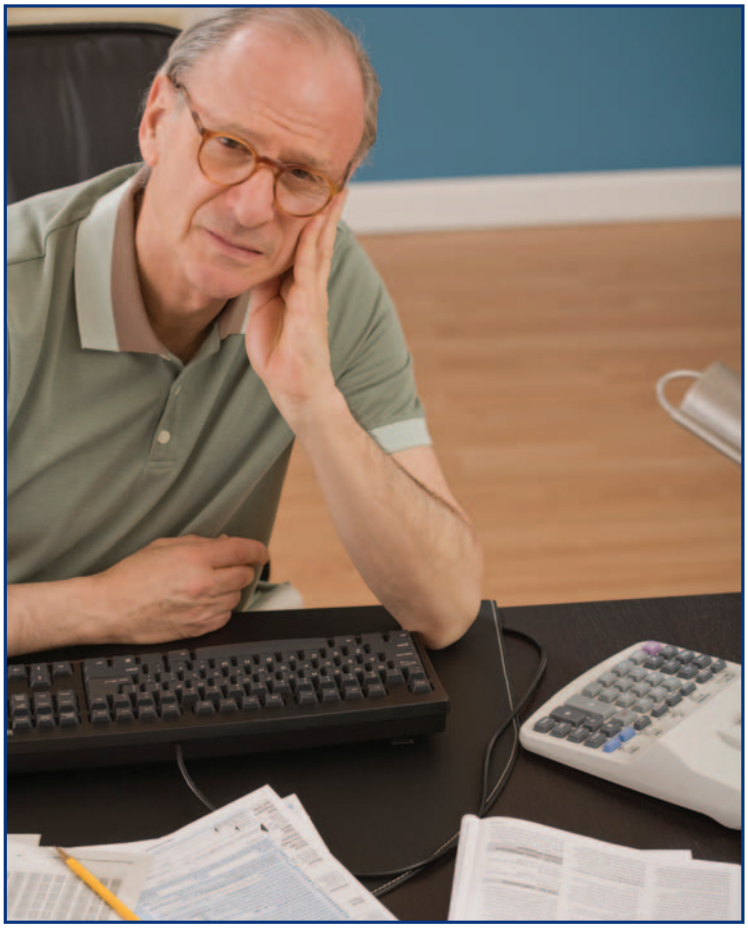
Suppose, however, that Dave dies in 2011, when the federal estate tax exemption has increased to \$5 million and his estate has grown to \$4 million. Under the terms of his plan, the entire \$4 million — all of which can be transferred free of federal estate tax — will pass to the trust, leaving nothing for Ann.

The outcome might be even worse if Dave lives in a state that has "decoupled" from the federal exemption. If, for example, the applicable state exemption is \$2 million, half of the money transferred to the trust will be subject to state estate tax.

While even a qualified professional couldn't have predicted in 2003 what the estate tax exemption would be at Dave's death, he or she could have structured a plan that would provide the flexibility needed to respond to tax law changes.

Don't try this at home

These are just a few examples of the many pitfalls associated with DIY estate planning. To ensure that you achieve your estate planning objectives, it's important to have your documents prepared — or, at the very least, reviewed — by a qualified professional. Then, have a professional review your plan periodically to be sure it's up to date. ✤



Postmortem affairs

What you need to do after a family member's death

Bob had always leaned on his brother, John, in times of hardship. After the deaths of their parents it was John who took care of the funeral arrangements and put their estates in order. Now, after John's death, Bob is at a loss as to what needs to be done to take care of his brother's legal and financial matters. If you find yourself in this situation, here's what you need to do.

Will or living trust document

Your first step is to locate your loved one's will or living trust document. Places to look include safe deposit boxes, safes or strongboxes, or filing cabinets. Next, contact the attorney who drafted your loved one's will or living trust and make an appointment.

If the attorney can't be identified or the deceased didn't have one, an attorney should be retained by the personal representative named in the will and/or the trustee of the living trust. Further, if you find that your loved one died without a will or living trust, consult legal counsel about steps you should take to initiate court administration of the estate.

If assets pass under a will, the deceased's personal representative should consult legal counsel about initiating probate proceedings. If you're named as the personal representative, remember that you have no authority to act on behalf of the estate until a court accepts the will as valid and appoints you to act in that capacity.

Don't pay outstanding bills until you've inventoried all of the deceased's assets and debts and compiled a complete list of his or her creditors.

If the deceased had a living trust, the trustee can begin managing the deceased's affairs immediately, without the need for court proceedings.

Assets and liabilities

Assuming you're the personal representative or trustee, you'll need to conduct an inventory of your loved one's assets and liabilities, paying particular attention to assets that may require immediate attention, such as life insurance policies, stock options and retirement plans. If probate is required, be sure your attorney moves quickly so the court can address the disposition of stock options and other time-sensitive assets.

Don't pay any outstanding bills until you've inventoried all of the deceased's assets and debts and compiled a complete list of his or her creditors.

Life insurance and Social Security

To file a life insurance claim, contact the deceased's insurance agent. You'll likely need to furnish the following to the life insurance company: a death certificate; insurance policy numbers and amounts; the deceased's full name, address and date and place of birth; the deceased's occupation and last place of employment; and the beneficiary's name, address, age and Social Security number.

To apply for spousal and dependent benefits, contact your local Social Security office. You'll need to furnish a certified copy of the death certificate; the deceased's Social Security number, proof of age and marriage certificate; the deceased's employer information, approximate earnings in the year of death and earnings records for the previous year; and Social Security numbers and proof of age for the deceased's spouse and dependents.

Turn to a professional for help

Bob isn't alone in not knowing how to handle the administrative matters after a loved one's death. Many people turn to their own estate planning advisor for assistance. He or she can help you get your loved one's legal and financial affairs in order under difficult circumstances. ✤

Estate Planning Red Flag

You don't know the value of your assets

With the gift and estate tax exemptions currently at $5 million ($10 million for married couples), you might think that estate valuations are less important. But even if you believe that your estate's value is under the exemption amount, there are several good reasons to determine the value of your assets.

First, you may be surprised just how much your estate is actually worth. For example, if you own an insurance policy on your life, the death benefit will be included in your estate, which may be enough to trigger estate tax liability.

Second, the gift and estate tax exemptions are scheduled to drop to only $1 million in 2013. Unless Congress extends the current exemptions or makes them permanent, you'll need to know the value of your assets to identify appropriate estate planning strategies.

Third, obtaining a qualified appraisal can limit the IRS's ability to revalue your assets. If you make gifts that exceed the $13,000 annual gift tax exclusion, you'll need to file a gift tax return, even if the gift is within your $5 million lifetime exemption. Generally, the IRS has three years to audit gift tax returns and challenge reported values for gifted assets. But that period doesn't begin until the gift has been "adequately disclosed."

For assets that are difficult to value — such as closely held business interests or real estate — the best way to satisfy the adequate-disclosure requirements and avoid an IRS challenge is to include a qualified professional appraisal with your return.

Finally, knowing the value of your assets can help you distribute the property according to your goals. Suppose you wish to divide your assets equally among your children. Unless you know what your assets are worth, there's no way to be sure you're treating your children fairly.

EXPERIENCE. RESPONSIVENESS. VALUE.

At Shumaker, we understand that when selecting a law firm for estate planning and related services, most clients are looking for:

- A high level of quality, sophistication, and experience.
- A creative and imaginative approach that focuses on finding solutions, not problems.
- Accessible attorneys who give clients priority treatment and extraordinary service.
- Effectiveness at a fair price.

Since 1925, Shumaker has met the expectations of clients that require this level of service. Our firm offers a comprehensive package of quality, experience, value and responsiveness with an uncompromising commitment to servicing the legal needs of every client. That's been our tradition and remains our constant goal. This is what sets us apart.

Estate planning is a complex task that often involves related areas of law, as well as various types of financial services. Our clients frequently face complicated real estate, tax, corporate and pension planning issues that significantly impact their estate plans. So our attorneys work with accountants, financial planners and other advisors to develop and implement strategies that help achieve our clients' diverse goals.

Shumaker has extensive experience in estate planning and related areas, such as business succession, insurance, asset protection and charitable giving planning. The skills of our estate planners and their ability to draw upon the expertise of specialists in other departments — as well as other professionals — ensure that each of our clients has a comprehensive, effective estate plan tailored to his or her particular needs and wishes.

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We welcome the opportunity to discuss your situation and provide the services required to help you achieve your estate planning goals. Please call us today and let us know how we can be of assistance.

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