

Trust Topics



Pending Estate Tax Changes

Making Gifts Today Can Lock in Favorable Estate Tax Exemptions

The estate planning landscape is scheduled to change significantly on January 1, 2010. There is much speculation that Congress will delay, or even revise these legislated changes. If they do nothing, then government revenues from estate taxes will fall to zero in 2010 at a time when the federal deficit is expected to remain high. Then in 2011, the burden shifts to estates, when estate tax rates will be higher and exemptions will be lower than today.

EXPECT DRAMATIC ESTATE TAX CHANGES FOR 2010 AND BEYOND

Scheduled Estate Tax Changes under the Current Law

Year	Federal Estate ¹	TAX EXEMPTION Generation Skipping Transfer	Cumulative Gift	Top Marginal Tax Rate
2009	\$3.5 million	\$3.5 million	\$1.0 million	45%
2010	\$0	\$0	\$1.0 million	0% (no estate tax)
2011 and thereafter	\$1.0 million	\$1.0 million ²	\$1.0 million	55%

THE PLANNED ESTATE TAX CHANGES MAY BE REVISED

It is anticipated that Congress will decide to overhaul these planned changes. Possible revisions include:

- Making the 2009 rates and exemptions permanent or extending them for one year only
- Reducing or increasing the exemptions
- Unifying the gift and estate exemptions

HOW TO LOCK IN A FAVORABLE EXEMPTION USING AN INNOVATIVE TRUST SOLUTION

If you are a married couple and wish that your estate ultimately benefits your grandchildren (or other future generations), there are important steps you can take now to lock in one of today's most attractive gift and estate tax benefits—the Generation Skipping Transfer (GST) tax exemption.

In 2009, the estate tax law allows each individual to transfer up to \$3.5 million to grandchildren or future generations, free of the 45% Generation Skipping Transfer tax. But, this favorable exemption is scheduled to be reduced to \$1 million in 2011. How can you lock in today's advantageous \$3.5 million GST tax exemption?

One solution is for one spouse to transfer assets into a special type of marital trust, called a Qualified Terminable Interest Property (QTIP) trust. With a QTIP trust, the surviving spouse receives income for life from the trust, and the principal is left to someone else. By transferring assets to the QTIP trust, no gift tax is paid, since spouses can transfer unlimited amounts between each other outright, or into qualifying trusts.

THE POTENTIAL BENEFITS OF A REVERSE QTIP ELECTION

Typically, the assets in a QTIP trust are included in the recipient spouse's estate, and the estate and GST laws in effect at the recipient spouse's death apply. There is a special election, however, known as a "Reverse-QTIP" election, that allows a married couple to take advantage of the GST exemption amount in effect in the year the gift was made.

1. Currently called the Applicable Exclusion Amount

2. Indexed for inflation

So if the gift is made in 2009, and a Reverse-QTIP election is made over the QTIP trust, the GST tax exemption can be locked in at today's \$3.5 million exemption amount (rather than at a presumably lower exemption amount in effect the year of the recipient spouse's death).

HOW A REVERSE QTIP TRUST WORKS

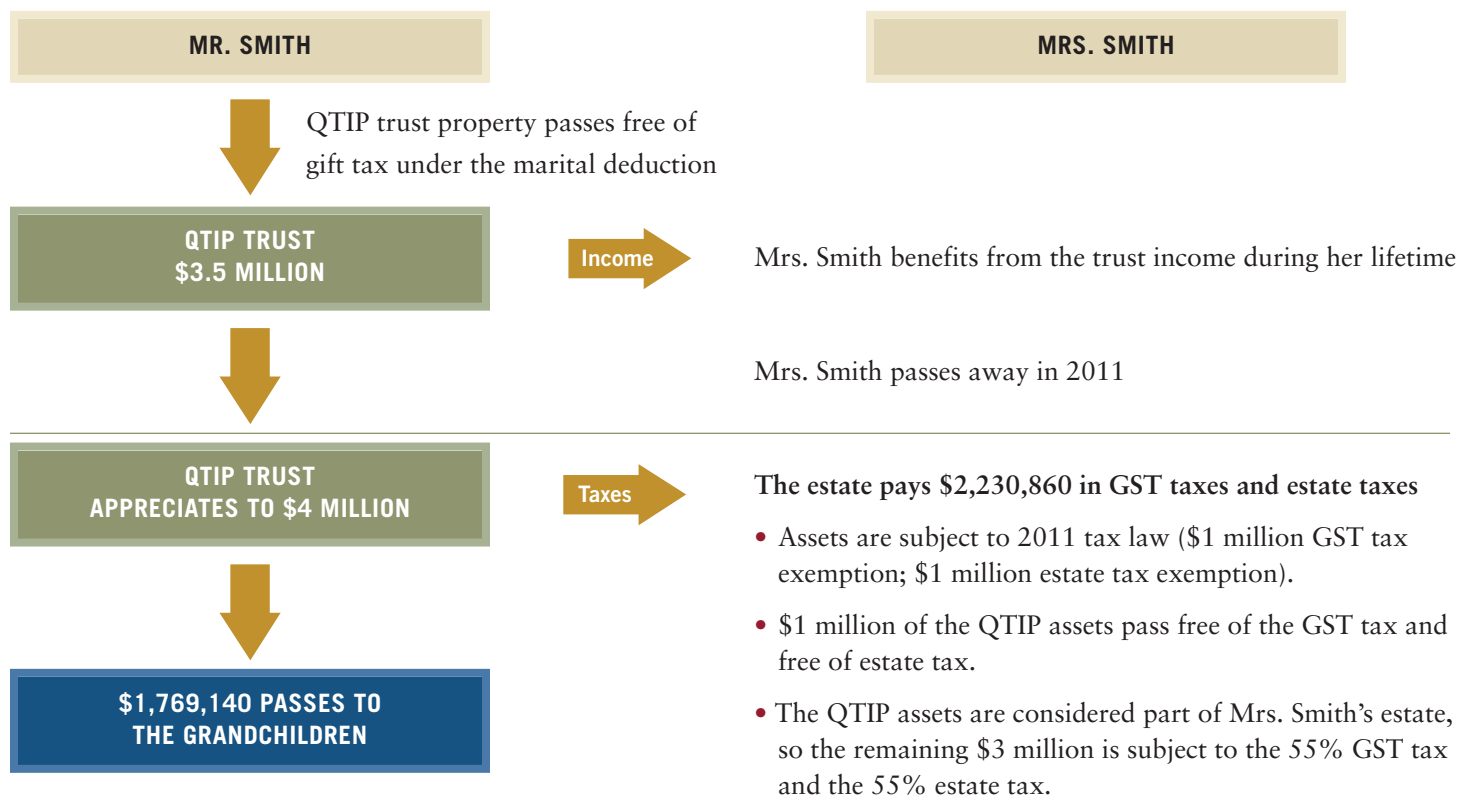
To illustrate the benefits of this strategy, consider the following comparison:

QTIP Trust *without* the Reverse-QTIP Election

Does Not Utilize Today's Favorable GST Tax Exemption Amount

Mr. Smith transfers \$3.5 million into a QTIP trust in 2009, without making the Reverse-QTIP election on his gift tax return, which is filed in April 2010. Mrs. Smith is the income beneficiary and at her death, the trust passes to her grandchildren. Suppose Mrs. Smith passes away in the year 2011 and the trust has appreciated to \$4 million. The maximum allowable GST tax exemption in the year of her death would be only \$1 million if Congress makes no changes to current law. In addition to paying an estate tax, the QTIP trust will be subject to GST tax on \$3 million, greatly reducing the amount transferred to the grandchildren.

QTIP Trust without the Reverse-QTIP Election



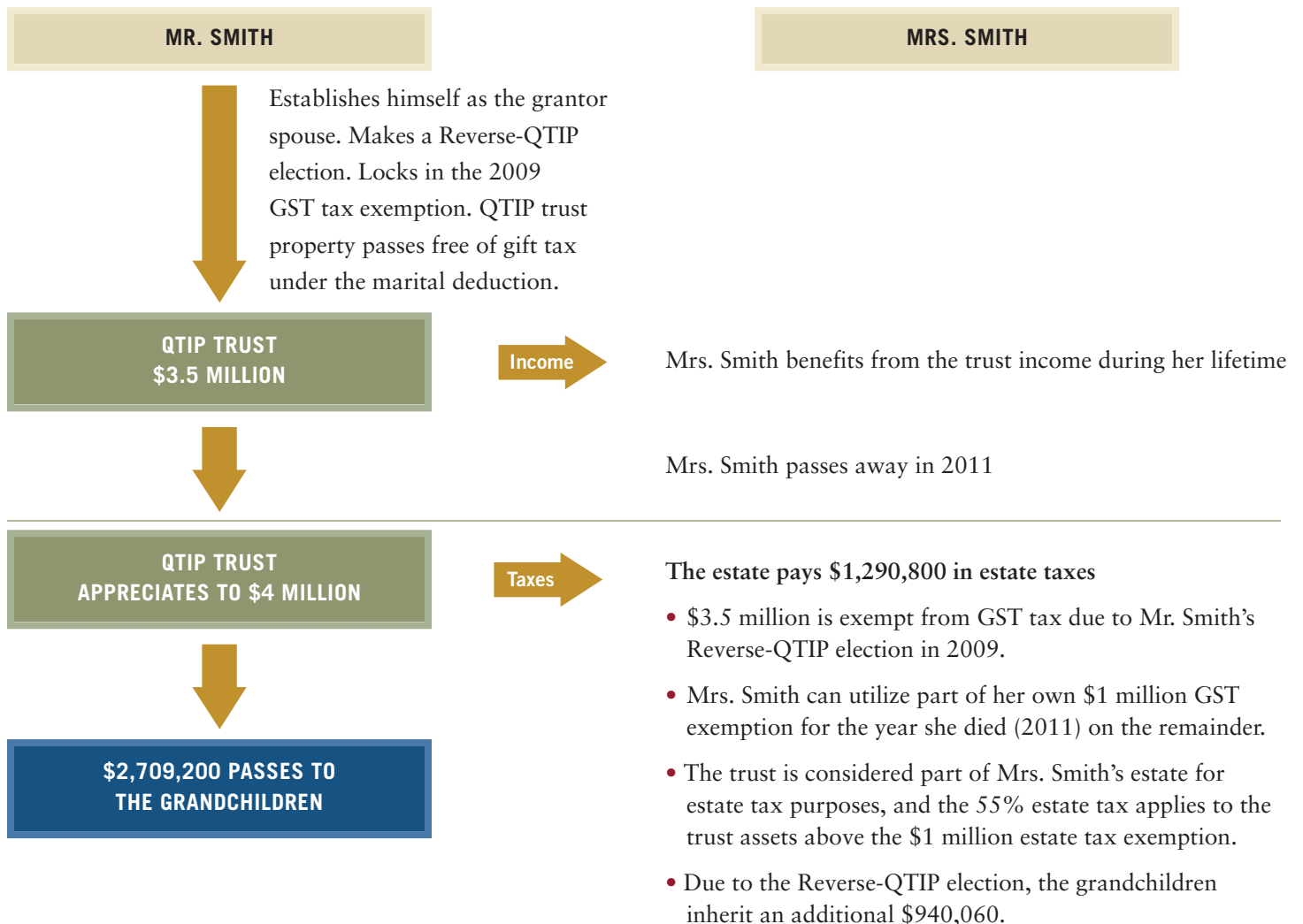
A QTIP Trust *with* the Reverse-QTIP Election

Can Take Advantage of Today's Higher GST Tax Exemption Amount

Mr. Smith transfers \$3.5 million into a QTIP trust in 2009. He makes a Reverse-QTIP election on his gift tax return. Mr. Smith has now locked in the 2009 \$3.5 million Generation Skipping Transfer tax exemption and the entire trust and all growth in it will pass GST tax free to the grandchildren.

Mrs. Smith still receives the income from the trust until her death in the year 2011. At this time, the QTIP assets appreciated to \$4 million. There will be no GST tax at her death because the entire trust is exempt.

QTIP Trust with the Reverse-QTIP Election



WE ARE HERE TO HELP

While a Reverse-QTIP can offer significant benefits, it is not suitable for everyone. For example, once the trust is created, the terms cannot be changed, even if a couple divorces. If you have questions about this and any other year-end planning strategies, we encourage you to reach out to your Fiduciary Trust contact.

GLOSSARY OF TERMS

Generation Skipping Transfer Tax (GST)—A grandparent either leaves assets directly to grandchildren or leaves assets in a trust that ultimately benefits grandchildren. A GST tax is imposed to assure that tax is collected as assets pass to each generational level.

Gift Tax—A tax on property that one living person gives to another.

Marital Deduction—Provides spouses with the ability to distribute unlimited assets to a surviving spouse without estate or gift tax.

Qualified Terminable Interest Property (QTIP)—A trust that can qualify for the marital deduction. The surviving spouse must receive all income for life.

Reverse-QTIP—Treats the spouse who makes the gift, not the recipient spouse, as the transferor.

About the Author

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