



**Dbriefs U presents:**

**Life! Death! Love! Hate!**

**Greed! Benevolence! Taxes!**

**Welcome to the World of  
Estate Planning**

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# Agenda

Gift and estate taxes

The premise of estate planning

Comprehensive case study using specific planning ideas

A few other planning ideas

Charitable giving

Dynasty trusts

## History of gift and estate tax (2001–2013)

Calendar year	“Gift tax exemption”	“Estate tax exemption”	Highest estate or gift tax rates
2001	\$675,000	\$675,000	55%
2002	\$1,000,000	\$1,000,000	50%
2003	\$1,000,000	\$1,000,000	49%
2004	\$1,000,000	\$1,500,000	48%
2005	\$1,000,000	\$1,500,000	47%
2006	\$1,000,000	\$2,000,000	46%
2007	\$1,000,000	\$2,000,000	45%
2008	\$1,000,000	\$2,000,000	45%
<b>2009</b>	<b>\$1,000,000</b>	<b>\$3,500,000</b>	<b>45%</b>
<b>2010</b>	<b>\$1,000,000</b>	<b>\$5,000,000**</b>	<b>35%</b>
<b>2011–12</b>	<b>\$5,000,000*</b>	<b>\$5,000,000*</b>	<b>35%</b>
<b>2013 on</b>	<b>\$1,000,000</b>	<b>\$1,000,000</b>	<b>55%</b>

\* Inflation adjusted starting in 2012.

\*\* An election out of the tax is available in this year, but then you get carryover basis.

## But I was so enjoying my holiday...

### New tax legislation:

- Retroactive reinstatement of the estate tax to decedents dying after December 31, 2009 (i.e., there is no estate tax holiday in 2010)
- The estates of 2010 decedents are permitted to elect out of the estate tax and into the carryover basis provisions of now repealed Sec. 1022 as if it had not been repealed (Act. Sec. 301(c))
- Common sense suggests that estates >\$5M would elect out of estate tax
- What complicates the analysis is that under the Act, the top rates for both the income and estate taxes is 35%

# Gift and estate taxes today (2011–2012)

## Wealth transfer taxes have NOT gone away!

Gift taxes	Estate taxes
Transfer of property during <b>LIFE</b> subject to gift tax	Transfer of property at <b>DEATH</b> subject to estate tax
Top federal rate: 35% (2010–2012)	Top federal rate: 35% (2010–2012)
Unlimited marital deduction	Unlimited marital deduction
Unlimited charitable deduction	Unlimited charitable deduction
Unlimited education/medical exclusion	N/A
\$13,000 annual exclusion per donee	N/A

# Gift and estate taxes today (2011–2012)

Gift taxes	Estate taxes
\$5,000,000 unified lifetime gift exemption	\$5,000,000 unified estate exemption (Potential portability of spouse's unused exemption)
Donee receives carryover tax basis (+ gift tax paid on appreciation)	Tax basis stepped up or down to FMV at death

## Exemption portability — A many-splendored thing

- The unused exemption from a deceased spouse may be used in addition to the taxpayer's \$5 million exemption
- The executor of the deceased spouse's estate **must elect** portability and compute the amount to which the surviving spouse is entitled
- It is clear that no relief will be extended to a missed election

## What no one saw coming — New gift tax rules

- For tax years beginning January 1, 2011:
  - The exclusion for gift tax purposes is reunified with the estate tax exclusion at \$5M per donor increased, where appropriate, by any unused deceased spousal exemption
  - The gift tax rate schedule follows the estate tax rate schedule, thus the highest marginal gift tax rate remains 35%
- Ability for taxpayers who already used their lifetime gifting exclusion of \$1 million to make additional gifts without incurring gift tax

# Sunset and what lies beyond 2012

## Bad news:

- In 2013, the current tax law “sunsets” and we return to pre-2001 law with a 55% estate, gift, and generation-skipping transfer tax (GSTT) top tax rate and a \$1 million estate and gift tax exemption
- Portability of exemption also “sunsets”
- Separate state inheritance tax laws could produce unexpectedly high effective tax rates

# Sunset and what lies beyond 2012

## Uncertainty:

- Will the law be changed during the next two years?
- Will the sunset be extended?

Year	Rate	Exemption
2002	50%	\$1 million
2009	45%	\$3.5 million
2010–2012	35%	\$5 million
2013*	55%	\$1 million

\*If no additional legislation is passed, 2013 will return to 2000 levels.

# Generation-Skipping Transfer Tax (GSTT)

## GSTT is applied in addition to the gift tax

- Bob gives \$20,000 to his grandson, Billy, in 2011
- Assuming Bob has fully utilized his applicable credit amount, lifetime GST exemption, and gift tax annual exclusion:

Gift tax: ( $\$20,000 \times 35\%$ )	\$7,000
GST tax: ( $\$20,000 \times 35\%$ )	\$7,000
Gift tax on GST: ( $\$7,000 \times 35\%$ )	\$2,450
<b>Total taxes</b>	<b>\$16,450</b>

**Effective tax rate: 82.25% ( $\$16,450/\$20,000$ )**

# The premise of estate planning

## There are four things you can do with money:

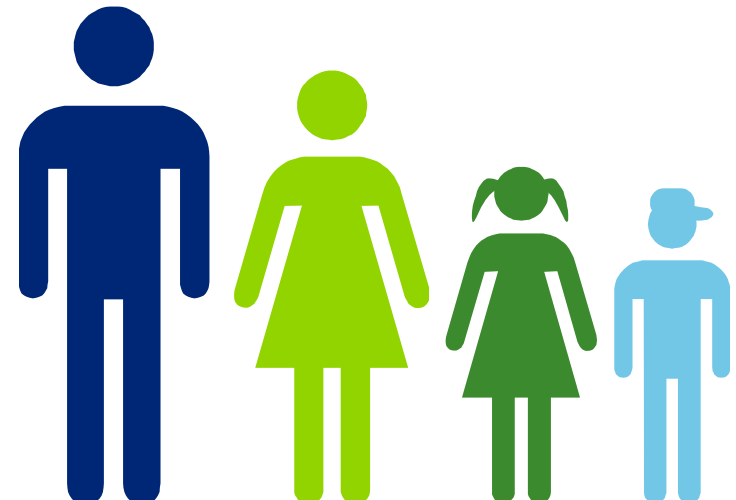
- Spend it
- Give it away (to charity)
- Give ~35% of it to the U.S. Treasury
- Utilize gift and estate planning techniques to maximize assets passed to future generations

## Here is an example of what a little planning can do...

# Comprehensive case study — Introduction

## Troy and Gabriella Bolten

- Assets equal to \$20 million
- Life insurance policy, personally owned, \$3 million death benefit, replacement cost of \$800,000, Gabriella is the designated beneficiary
- Troy dies in 2011, leaving everything to Gabriella
- Gabriella dies in 2012, leaving everything to their children: Sharpay and Ryan
- No change in estate value between deaths



## Comprehensive case study — Base case

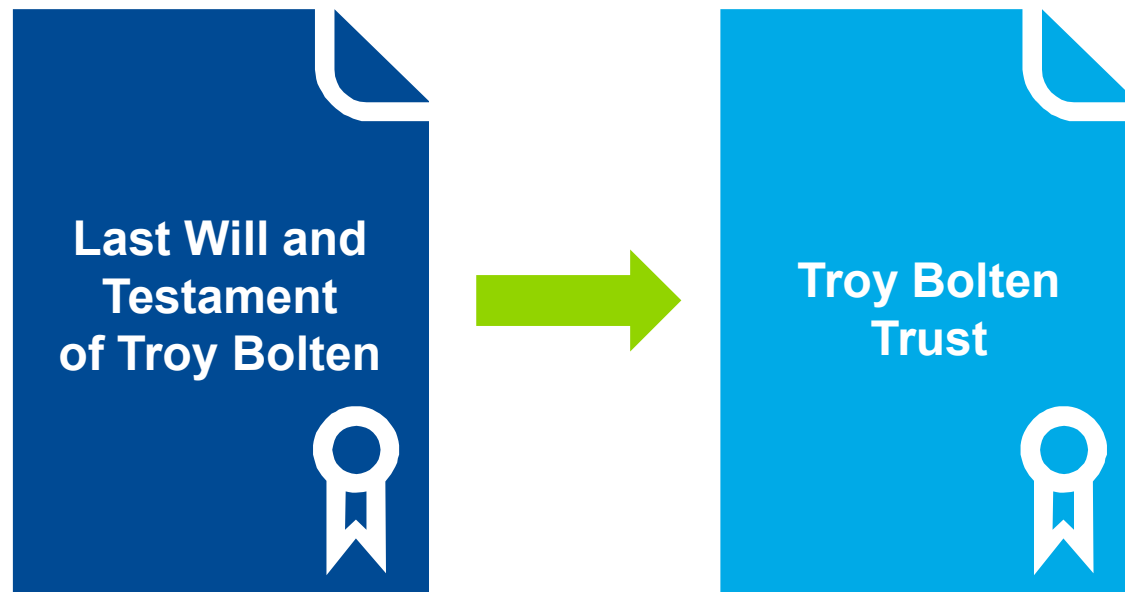
	Troy	Gabriella
<b>Gross estate</b>	\$23,000,000	\$23,000,000
<b>Marital deduction</b>	\$23,000,000	\$0
<b>Taxable estate</b>	\$0	\$23,000,000
<b>Estate tax</b>	\$0	\$8,030,800
<b>Applicable credit amount*</b>	\$0	(\$3,461,600)*
<b>Net estate tax</b>	\$0	\$4,569,200
<b>Sharpay and Ryan</b>		\$18,430,800

**Effective estate tax rate: 19.9% (\$4,569,200/\$23,000,000)**

\*Assumes executor of Troy's estate made the exemption portability election.

## Planning concept #1 — Revocable trust

- During life, Troy established a revocable trust and pour-over will:
  - Not a tax-savings vehicle
  - Assets held in a revocable trust and the estate's assets are included in the gross estate for taxable purposes
- Case study estate tax is still \$4,569,200 and 19.9% effective rate



## Planning concept #2 — A/B trusts

### Utilizing the typical “A/B Trust” estate plan

The “**B trust**” (aka: “credit shelter trust,” “bypass trust,” or “family trust”)

- Ensures utilization of estate exemption amount for **each** estate
- Places assets equal to applicable exclusion amount (\$5 million in 2011) in trust for surviving spouse and family
- Trust income can be provided to spouse, remainder of assets set aside for children and other family members

## Planning concept #2 — A/B trusts (cont.)

### Utilizing the typical “A/B Trust” estate plan

The “**A trust**” (aka: “marital trust” or “Qualified Terminable Interest Property (QTIP) trust”)

- Assets placed into trust can qualify for the unlimited estate tax marital deduction
- Included in surviving spouse’s estate at their death
- Trust income can be provided to spouse, remainder of assets set aside for children and other family members

## Planning concept #2 — A/B trusts (cont.)

### The two general types of “A” trusts

- Marital trusts
  - Mandatory income distributions to surviving spouse
  - General power of appointment (“A” = appointment) over remainder
- QTIP
  - Qualifying income interest for life of surviving spouse
  - Original owner decides remainder recipient
  - Why use a QTIP?

# Comprehensive case study — Updated

## Utilizing a revocable trust with an A/B trust plan

	Troy	Gabriella	
Gross estate	\$23,000,000	\$18,000,000	
Marital deduction	\$18,000,000	\$0	← Amount passing to marital trust
Taxable estate	\$5,000,000	\$18,000,000	← Amount passing to bypass trust
Estate tax	\$1,730,800	\$6,280,800	
Applicable credit amount	(\$1,730,800)	(\$1,730,800)	
Net estate tax	\$0	\$4,550,000	
Sharpay and Ryan		\$18,450,000	

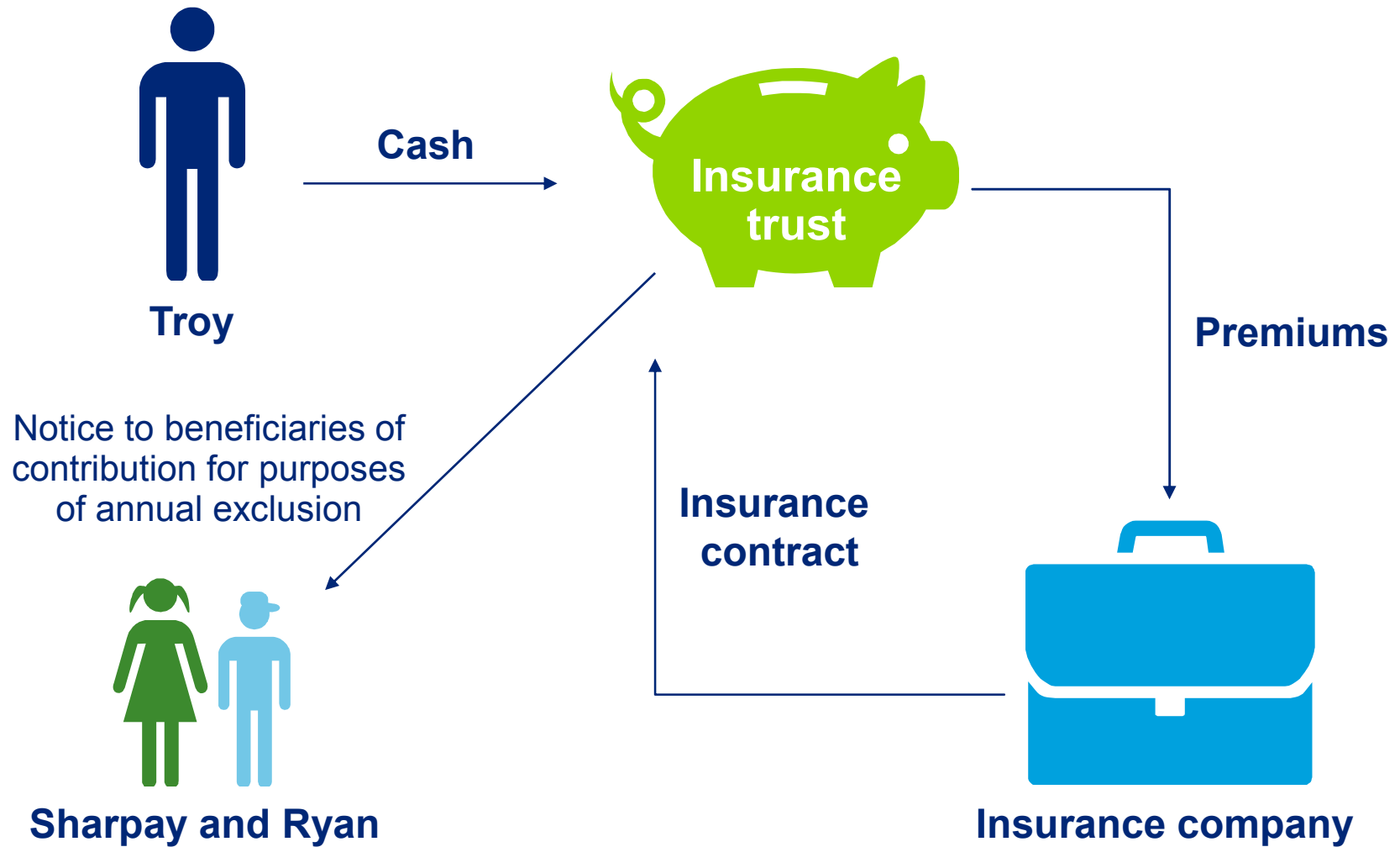
Effective estate tax rate: 19.8% (\$4,550,000/\$23,000,000)

# Planning concept #3 — ILIT

## Life insurance

- Provides liquidity for estate
  - Pay off creditors of estate, funeral costs
  - Pay death taxes and expenses
- Proceeds received are generally income tax free
- Proceeds received can be estate tax free if policy is transferred to an irrevocable life insurance trust (ILIT)
  - Gift tax amount, if any, much smaller
  - Can still pay premiums

## Planning concept #3 — ILIT (cont.)



# Comprehensive case study — Updated

## Utilizing a revocable trust and an ILIT

	Troy	Gabriella	ILIT
<b>Gross estate</b>	\$20,000,000*	\$15,000,000	\$3,000,000
<b>Marital deduction</b>	\$(15,000,000)	\$0	
<b>Taxable estate</b>	\$5,000,000	\$15,000,000	\$3,000,000
<b>Estate tax</b>	\$1,730,800	\$5,230,800	
<b>Applicable credit amount*</b>	\$(1,730,800)	\$(1,730,800)	
<b>Net estate tax</b>	\$0	\$3,500,000	
<b>Sharpay and Ryan (in trust)</b>		<b>\$19,500,000</b>	

**NEW effective estate tax rate: 15.2% (\$3,500,000/\$23,000,000)**

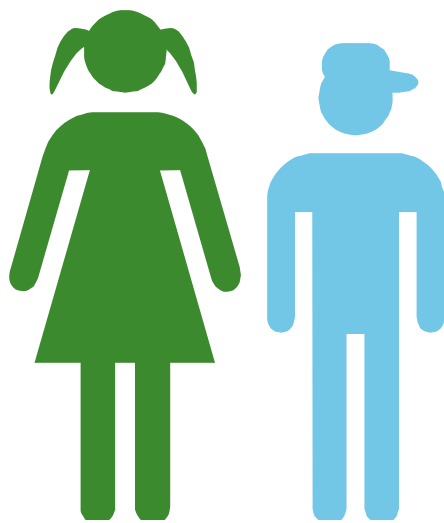
\*\$23 million estate less \$3 million life insurance policy transferred to ILIT.

## Comprehensive case study — Conclusion

	No planning	A/B trust	A/B trust and ILIT
<b>Estate tax</b>	\$4,569,200	\$4,550,000	\$3,500,000
<b>Effective tax rate</b>	19.9%	19.8%	15.2%
<b>Amount transferred outright</b>	\$18,430,800	\$8,450,000	\$6,500,000
<b>Amount transferred via trust</b>	\$0	\$10,000,000	\$13,000,000
<b>Total amount transferred</b>	\$18,430,800	\$18,450,000	\$19,500,000

## Other idea — World's cleanest estate plan

- Give it all to charity!
- No transfer taxes!



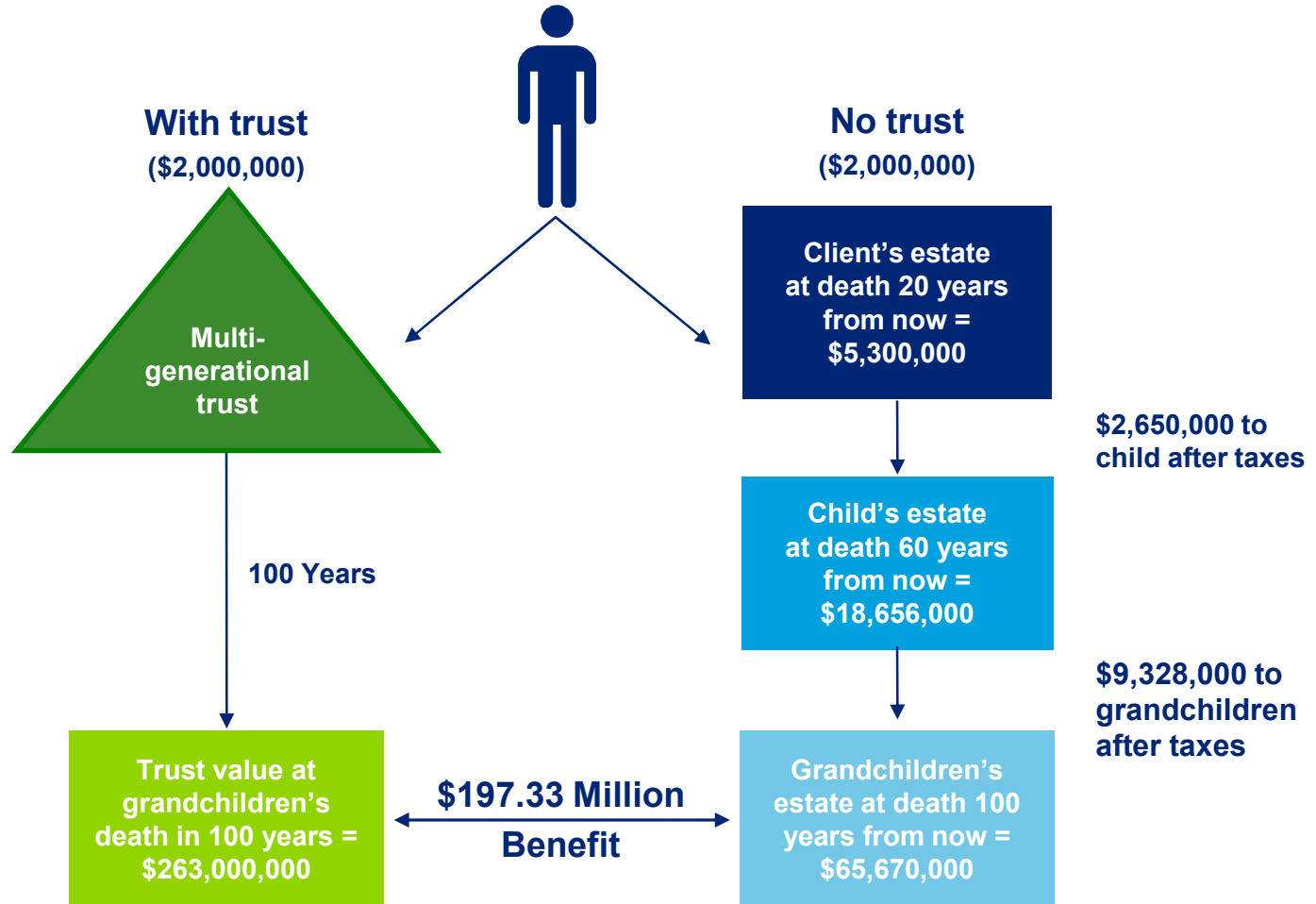
## Other idea — Dynasty trusts

- Multigenerational trusts (“dynasty trusts”) can be structured to take care of children first, grandchildren second, great-grandchildren third, etc., without inclusion of the trust assets in the estate of the grantor or any of the trust’s beneficiaries
- If the trust is established in a state with no rule against perpetuities, the trust could benefit future generations forever with no future gift, estate, or generation-skipping transfer tax consequences (e.g., a “perpetual trust”)

# Dynasty trusts — Illustration

## The power of effective multi-generational planning

Assets appreciate at 5% after-tax rate; estate tax rate assumed to be 50%



## Poll question #1

A client wants to make a gift of \$5.5M in 2011 to her child in college studying accounting and consuming large amounts of ramen noodles. Assuming she has made no prior taxable gifts and has already gifted her annual exclusion to her child, how much gift tax will she pay?

- Nothing, the gift is fully covered by the unlimited educational exclusion
- \$175,000 in tax (tax on taxable gift of \$500,000)
- \$1,575,000 in tax (tax on taxable gift of \$4.5M)
- \$1,905,800 in tax (tax on taxable gift of \$5.5M)

## Poll question #2

From a tax policy standpoint, what amount do you think should be exempt from estate taxes (per person)?

- \$0
- \$2,000,000
- \$5,000,000
- \$20,000,000
- Unlimited

## Poll question #3

Which of these techniques will not save estate taxes?

- Revocable trust
- ILIT (irrevocable life insurance trust)
- Charitable bequest

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