ESTATE PLANNING UPDATE

Freeborn & Peters LLP

Where Do We Go From Here?

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The new Tax Reform Act of 2010 ("TRA 2010") ushered in several key changes to the federal estate and gift tax rules. Additionally, Illinois reinstated its estate tax. A detailed discussion of these changes may be found here.

What is New for 2011:

- ***$5,000,000 Federal Gift, Estate and GST Exemption.*** Every taxpayer may make lifetime gifts of up to $5,000,000 without paying gift tax. Leverage it if you can, and consider using it to benefit multiple generations of family members.
- ***Portability of Exemption.*** Married decedents have a new "portability" election, through which they can give to their surviving spouse any portion of their $5,000,000 estate and gift tax free amount that they don't use. But to get it, a federal estate tax return has to be timely filed, even though one isn't otherwise required. A federal estate tax return should now be filed in the estate of every married decedent.
- ***The Illinois Estate Tax is Back.*** Retroactive to January 1, 2011, Illinois will assess an estate tax on all estates in excess of $2,000,000, at rates of 8% to 16%. Because the Illinois tax free amount is less than the federal tax free amount, many estates that are free of federal estate tax will attract Illinois estate tax up to $352,000. Estate plans should be reviewed in order to fix this.
- ***2010 Decedents*** have many available elections to minimize estate, generation-skipping and income taxes, including an extended period for restructuring the estate through disclaimers. You have until September 19, 2011 to file federal estate and generation-skipping transfer tax returns for 2010 decedents, and to make these elections and disclaimers. Don't lose out!

Advanced Planning: Use it or Lose it:

While TRA 2010 raised the gift and estate exemption to $5,000,000, it left in place many other estate planning tools that had been limited or eliminated in earlier proposed legislation. As budgetary pressures come to bear, these advanced planning techniques may disappear. Now is the time of golden opportunity to shift wealth and minimize the estate and gift taxes. These advanced techniques include:

- ***Grantor Retained Annuity Trusts ("GRATs").*** This is a technique that transfers future appreciation on assets transferred to the trust on a tax free basis.
- ***Installment Sales to Grantor Trusts***, financed with low interest notes. There is no capital gains tax on assets sold to the trust, and interest payments (both paid and received) are disregarded for federal income tax purposes.
- ***Discounts.*** Closely-held family entities are wonderful vehicles to substantially discount the value of gifts of business interests, investments and real estate. Minority interests in such entities will have substantial valuation discounts for lack of control and lack of liquidity. These include Family Limited Partnerships and LLC's, which are structures designed to pool assets for investment purposes and make tax-efficient gifts to younger generations at substantial discounts while retaining family control over investments and distributions.
- ***Qualified Personal Residence Trusts.*** Such trusts, referred to as "QPRT's," allow you to give your residence to trust and retain the use of the residence for a period of years that you specify. At the end of the term, you may rent the residence from the trust. The net gift is the value of the home at the time of the gift, reduced by the present value of your retained residency right (based on actuarial calculations). QPRT's essentially let you discount the gift of a home by the value of your right to use the home rent free.

Don't Forget the Basics:

Basic estate planning tools remain viable and useful. These include:

- ***Irrevocable Life Insurance Trusts***, which shelter policy death benefits from federal estate tax on a gift tax free basis.
- ***$13,000 tax-free gifts*** can be given to any person, every year. There is no limit to the number of annual tax-free gifts that can be made by any taxpayer.

- ***Inter-family loans*** can be made at historically low interest rates. Loans for as long as 9 years may be made at interest rates as low as 2%.
- ***Asset Protection.*** Basic asset protection is important even for those who do not have an expected estate tax liability under the new $5,000,000 estate tax exemption.

What to Beware of:

- ***Reliance on Portability*** in planning estates. The portability rules only apply in 2011 and 2012, unless extended by Congress, and may be inadequate to fully shelter both estates in second marriage situations, where generation-skipping planning is used or when creditor protection is needed. For an in-depth discussion, see Basics of Estate Tax.
- ***Illinois Estate Tax*** is a substantial trap and will affect many estates below $5,000,000 and which otherwise would have no expectation of estate tax. For many, the Illinois estate tax may be completely avoided with the right estate plan.
- ***Increased Estate Taxes on Large Lifetime Gifts.*** Donors of gifts in excess of $1,000,000 need to make sure provisions are made for any estate taxes that may result from lifetime gifts that are larger than whatever the tax free amount is at the time of their deaths.

For more information, we encourage you to contact Bill Russell (312-360-6373 / brussell@freebornpeters.com) or Eileen Trost (312-360-6313 / etrost@freebornpeters.com).

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