

Window May Be Closing Soon on Significant Estate Planning Opportunities; Federal Estate and Gift Tax Provisions Set to Expire on December 31, 2012

- **All Time High Transfer Tax Exemptions:** The federal estate and gift tax exemption and the generation skipping transfer tax exemption are both at an all time high of \$5,120,000. (This is an increase for inflation over the 2011 exemption level of \$5,000,000).
- **Low Transfer Tax Rates:** The federal estate and gift tax rate and the generation skipping transfer tax rate are both at an all-time low of 35 percent.
- **However,** if Congress does not act to change the law, the transfer tax exemptions will *decrease* to \$1,000,000 and the transfer tax rates will *increase* to 55 percent beginning January 1, 2013.

In addition, proposals have been put forth which, if enacted into law, would limit some popular estate planning techniques starting next year, including the following:

- Possible reduction of the transfer tax exemptions to \$3.5 million.
- Possible increase of the transfer tax rate to 45 percent.
- Possible limitations on opportunities to transfer appreciating property out of an estate using a grantor retained annuity trusts (“GRATs”). GRATs may be required to have a minimum term of ten years, increasing the risk that the grantor could die during the GRAT’s term, thus causing the GRAT to be included in the grantor’s estate. The ability to establish a GRAT with a zero taxable gift may also be eliminated, creating potential gift tax liability.
- Possible limitations on the terms of so-called “Dynasty Trusts” to approximately 90 years.
- Possible inclusion of grantor trusts in the grantor’s taxable estate at death. This would, among other things, eliminate the ability to use the popular “sale to defective grantor trust” technique. A related proposal would subject any distributions made from a grantor trust during the grantor’s lifetime to gift tax.

WHAT DOES THIS MEAN FOR YOU?

No one can predict which proposals will actually be enacted or whether the scheduled decrease in the transfer tax exemptions will occur in the absence of Congressional action. However, you may wish to consult with your estate planning advisors as to whether, in appropriate circumstances, you should take action on your estate planning now in response to these potential changes in the law. Estate planning actions you may wish to take include:

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- Consider making gifts prior to the end of the year to lock in the use of your \$5,120,000 gift and generation skipping tax exemptions (to the extent you have not already used gift tax exemption on prior gifts). For clients in certain states, such as New York, such gifts can avoid state gift tax as well. Unfortunately, for our clients who are Connecticut residents, this may not necessarily be the case. For Connecticut residents, gifts in excess of \$2,000,000 (or \$4,000,000 for married couples) may result in a separate gift tax.

Caveat: Some commentators believe that if the federal exemption drops below its current level of \$5,120,000 and you have used gift tax exemption in excess of the new, lower exemption amount, you will be subject to a tax on the difference between the new, lower exemption amount and the amount of taxable gifts you made using the higher exemption amount. This is sometimes referred to as the “clawback risk.” If you are considering making gifts utilizing the increased gift tax exemption, you should discuss this clawback risk with your Wiggin and Dana attorney or other tax advisor.

- For clients who have used their \$5 million exemptions on gifts made by the end of 2011, consider making a gift of the additional \$120,000 of exemption that became available in 2012.
- If you are interested in making a gift to a Dynasty Trust established under the laws of a jurisdiction, such as Delaware, that allows the trust to last for more than the proposed 90 year limit, consider making such a gift before year-end.
- Consider establishing one or more of the following irrevocable trusts, or making additional gifts to existing trusts:
 - Grantor Retained Annuity Trust (“GRAT”). A GRAT is a trust into which you make a one-time transfer of property, and from which you receive a fixed amount annually for a specified number of years (the annuity period). At the end of the annuity period, the payments to you will stop, and any property remaining in the trust passes to the remainder beneficiaries named in the trust document (e.g., your children), outright or in trust. A GRAT is a useful strategy for excluding the growth from rapidly-appreciating assets from your estate.
 - Spousal Estate Reduction Trust (“SERT”). A SERT is a trust created for the benefit of your spouse and descendants. Your contributions to the trust use a portion of your gift tax exemption and will be excluded from your estate. Any assets you contribute to the SERT will appreciate free of estate taxes.
 - Qualified Personal Residence Trust (“QPRT”). A QPRT is designed to own a personal residence (i.e., your primary residence or a vacation home). The trust allows you to reside in the house rent-free for a term of years (the “QPRT term”). During the QPRT term, you use the residence almost as if you owned it outright. If you are living when the QPRT term ends, the residence will pass at that time tax-free to your designated beneficiaries, outright or in trust. A QPRT is intended to remove the value of the residence from your taxable estate at a discounted value for gift tax purposes.

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- Irrevocable Life Insurance Trust (“ILIT”). An ILIT is designed to own one or more life insurance policies on your life. If you transfer ownership of an existing life insurance policy to a properly drafted ILIT (and live for three years after the transfer), the proceeds will avoid taxation in your estate and in your surviving spouse’s estate. Instead, the life insurance will be taxed at its value at the time it was given to the trust. If the Trustee of the ILIT is the applicant for, original owner of and beneficiary of a new policy on your life, the death benefit paid on the new policy will not be taxable in your estate, even if you die within three years of the purchase of the policy. Those considering an ILIT should also consider prepaying the insurance premiums (thus making a larger taxable gift) in order to use a larger portion of their available gift tax exemption.

In conclusion, historically generous exemptions from the federal estate, gift and generation skipping transfer taxes are scheduled to expire on December 31, 2012. Timely planning to take advantage of these exemptions is essential, even if the value of your estate be less than \$5,120,000. We would welcome the opportunity to discuss what planning options are available to you in your particular circumstances.

ABOUT WIGGIN AND DANA’S PRIVATE CLIENT SERVICES DEPARTMENT

The department consists of skilled lawyers and paralegals with many years of experience. We offer individuals a full range of sophisticated estate planning and administration services, including the drafting of wills and trusts, probate and estate settlement services, trust administration, creation and administration of family foundations and partnerships, charitable giving techniques and tax return preparation.

ABOUT WIGGIN AND DANA LLP

Wiggin and Dana is a full service firm with more than 135 attorneys serving clients domestically and abroad from offices in Connecticut, New York City and Philadelphia. For more information on the firm, visit our website at www.wiggin.com.

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