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NEWSLETTER ~ SEPTEMBER 2011

The importance of

CREDIT SHELTER TRUST PLANNING – 2011, 2012, 2013 & BEYOND

There has been a lot of commentary lately suggesting that if people with taxable estates use a planning technique called Portability, which was created under the Tax Relief Act of 2010, they do not have to consider using Credit Shelter Trust planning.

Moreover, these commentators say that these people will save money by not having to work with an estate planning attorney. In fact, for most people with taxable estates (including those subject only to a state's estate tax), not taking advantage of Credit Shelter Trust planning will actually cost from tens of thousands to millions of dollars more in estate taxes.

This Newsletter is the first in a series, in which we will describe the advantages of using Credit Shelter Trusts with and without Portability. You will see that if you take advantage of Credit Shelter Trust planning, you could significantly increase, and in some cases more than double, the tax savings for you and your

family, regardless whether you use or don't use Portability.

The purpose of a Credit Shelter Trust (also known as a Bypass Trust, an A-B Trust, or a Family Trust) is to shelter from the estate tax assets in value up to the Applicable Exclusion Amount or your state's estate tax equivalent.* The assets can be sheltered from estate tax not only in your estate, but often in the estates of your descendants, and if you are married at your death, also in your spouse's estate.

The assets in the Credit Shelter Trust in the estate of the first spouse to die pass free of estate tax at the death of both spouses and the amount in the Credit Shelter Trust of the second spouse to die remains free of

* The Applicable Exclusion Amount (the amount that can pass free of estate tax other than the unlimited marital deduction and gifts to qualified charities) is currently for NY State, \$1,000,000, and for the Federal Government, \$5,000,000 in 2011 and 2012 and \$1,000,000 in 2013 and subsequent years.

estate taxes at the death of the second spouse. If the assets stay in the trust, they can be exempt from estate taxes in your children's and grandchildren's estates as well. And the assets of both trusts can be qualified to be free of Generation Skipping Transfer (GST) tax too. And any appreciation in the value of such assets is free of estate and GST tax as well.

Without proper Credit Shelter Trust planning, you stand to waste (that is, force your heirs to hand over to the state and federal tax authorities) the potential estate tax savings on the assets that would have gone into the Credit Shelter Trust, and on

the appreciation in value of those assets as well.

Moreover, if the first spouse to die leaves all of his or her assets to the surviving spouse using the unlimited marital deduction for estate tax, then the first spouse will have entirely wasted this substantial opportunity to avoid both estate tax and GST tax.

Below are examples showing how Credit Shelter Trust planning can reduce estate taxes significantly for people with substantial assets well below the current federal estate tax exemption limit of \$5,000,000, and who are unlikely to use Portability.

Example 1 – Individuals and Couples with Assets of More than \$1,000,000 – 2011 and 2012

Jack and Joanne Smythe are in their mid 60's and have a net worth of \$2,000,000. Jack has a \$1,000,000 investment account in his name, while their \$1,000,000 house is in Joanne's name. They also have \$1,000,000 of life insurance that is smartly owned in an irrevocable life insurance trust. They live comfortably on the income from their assets (including a substantial pension with no death benefit) and would like to leave as much of their estate as possible to their son Larry. Here is the result of estate taxation on their assets (assuming that New York estate tax rates do not change).

With No Credit Shelter Trust Planning – In their wills or revocable living trusts, Jack and Joanne leave everything to each other and then to their son Larry. Jack dies unexpectedly in 2012. Joanne dies fifteen years later. This example assumes there will still not be a Federal estate tax on estates of \$5,000,000 or less.

| | First Death (Jack) | Second Death (Joanne) |
|----------------------------------|---------------------------|------------------------------|
| Gross Estate | \$1,000,000 | \$2,000,000 |
| Marital Deduction | \$1,000,000 | \$0 |
| New York Taxable Estate | \$0 | \$2,000,000 |
| State Exemption (Credit Shelter) | Not Used | (\$1,000,000) |
| New York State Estate Tax | \$0 | \$99,600 |

The \$99,600 estate tax assumes that neither the investment account nor the value of the house increases in value between the date Jack dies and the date Joanne dies. How realistic is that? What if the assets increased in value fifty percent over fifteen years? Then Joanne would have \$3,000,000 at her death and Larry would be faced with \$182,000 in New York estate taxes.

With Credit Shelter Trust Planning – In his will or revocable living trust, Jack leaves \$1,000,000 to a credit shelter trust for the benefit of Joanne for life, then for the benefit of Larry; Joanne leaves the house in a credit shelter trust for Jack's benefit for life, then for the benefit of Larry. Again, we're assuming no Federal estate tax applies.

| | First Death (Jack) | Second Death (Joanne) |
|----------------------------------|---------------------------|------------------------------|
| Gross Estate | \$1,000,000 | \$1,000,000 |
| Marital Deduction | \$0 | \$0 |
| Taxable Estate | \$1,000,000 | \$1,000,000 |
| State Exemption (Credit Shelter) | (\$1,000,000) | (\$1,000,000) |
| New York State Estate Tax | \$0 | \$0 |

With Credit Shelter Trust planning, Jack and Joanne have saved \$96,000. Even if the assets in the Credit Shelter Trust appreciate, that appreciation is sheltered from estate taxes in Joanne's estate. If the house appreciates, then Joanne's estate would have an estate tax unless she has spent down the \$1,000,000 in liquid assets to compensate for the house value appreciation. Joanne could put the house in a special trust for real estate that would go to Larry outright at her death and avoid estate tax on the house too.

Example 2 – Individuals and Couples with Assets of More than \$1,000,000 – 2013 and Beyond

Same facts as Example 1: Jack and Joanne Smythe are in their mid 60's and have a net worth of \$2,000,000. Jack has a \$1,000,000 investment account in his name, while their \$1,000,000 house is in Joanne's name. Here is the result of estate taxation on their assets, assuming that New York estate tax rates do not change and Federal estate tax law also does not change before December 31, 2012 (**which means that the \$5,000,000 Federal estate tax exemption goes down to \$1,000,000 and portability ends**).

With No Credit Shelter Trust Planning – In their wills or revocable living trusts, Jack and Joanne leave everything to each other and then to their son Larry. Jack dies unexpectedly sometime after 2012. Joanne dies sometime after Jack.

| | First Death (Jack) | Second Death (Joanne) |
|-----------------------------|---------------------------|------------------------------|
| Gross Estate | \$1,000,000 | \$2,000,000 |
| Marital Deduction | \$1,000,000 | \$0 |
| Taxable Estate | \$0 | \$2,000,000 |
| State and Federal Exemption | Not Used | (\$1,000,000) |
| New York State Estate Tax | \$0 | \$99,600 |
| Federal Estate Tax | \$0 | \$335,400 |
| Total Estate Tax | \$0 | \$435,000 |

The \$435,000 total estate tax assumes that neither the investment account nor the value of the house increases in value between the date Jack dies and the date Joanne dies. How realistic is that? What if the assets of the Credit Shelter Trust increased in value fifty percent over fifteen years? Then Joanne would have \$3,000,000 at her death and Larry would be faced with a total for \$945,000 in combined New York and Federal estate taxes.

With Credit Shelter Trust Planning – In his will or revocable living trust, Jack leaves \$1,000,000 to a credit shelter trust for the benefit of Joanne for life, then for the benefit of Larry; Joanne leaves the house in a credit shelter trust for Jack's benefit for life, then for the benefit of Larry.

| | First Death (Jack) | Second Death (Joanne) |
|-----------------------------|---------------------------|------------------------------|
| Gross Estate | \$1,000,000 | \$1,000,000 |
| Marital Deduction | \$0 | \$0 |
| Taxable Estate | \$1,000,000 | \$1,000,000 |
| State and Federal Exemption | (\$1,000,000) | (\$1,000,000) |
| New York State Estate Tax | \$0 | \$0 |
| Federal Estate Tax | \$0 | \$0 |
| Total Estate Tax | \$0 | \$0 |

With Credit Shelter Trust planning, Jack and Joanne have saved \$435,000. Even if the assets in the Credit Shelter Trust appreciate, that appreciation is sheltered from estate taxes in Joanne's estate. As before, if the house appreciates, Joanne's estate will have an estate tax to pay unless she has spent down the \$1,000,000 in liquid assets to compensate for the house value appreciation. Joanne could put the house in a special trust for real estate that would go to Larry outright at her death and avoid estate tax on the house too.

Next month we will illustrate examples of how Credit Shelter Trust planning can help save significant estate taxes and GST taxes for people with more than \$5,000,000, both using and not using Portability.

Please let us know if you would like to discuss ways that you can reduce or eliminate State and Federal Estate Taxes, Gift Taxes and Generation Skipping Transfer Taxes. We look forward to helping you.

^What we believe: In everything we do we believe in one size fits none. We believe in customized solutions for every client – solutions that realize or exceed client goals, reduce or eliminate client concerns and do so in the context of each client's values and complexity threshold. We help trustees and executors do their jobs right; we help beneficiaries enforce their rights; we help clients from the mildly well off to the abundantly wealthy design, implement and maintain estate planning and asset protection plans designed for each client's specific needs, concerns and goals.

This Newsletter is not legal advice. For more information, to request a family wealth and legacy consultation or to discuss engaging us to help you, please

contact us at 212-682-1555 or by email at info@maclean-law.com.

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