

Estate planning and the 2010 tax-relief legislation

A two-year window of opportunity

Estate provisions summary

- The estate tax applicable exclusion increases to \$5 million.
- A flat rate of 35% applies to estates above \$5 million.
- The estate and gift tax exemptions are re-unified at \$5 million.
- The generation-skipping tax exemption increases to \$5 million.
- These rules “sunset” at the end of 2012. In 2013, the estate tax would return to a \$1 million exemption and a top rate of 55% - unless Congress acts before the sunset takes effect.

The “Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010” set a \$5 million exclusion amount for the estate tax, gift tax and generation-skipping tax. (The exclusion means that estates below \$5 million do not owe federal estate tax.) The act also reduced estate- and gift-tax rates to 35%. These rules remain in effect for 2011 and 2012. In 2013, the estate tax reverts to a \$1 million exclusion and 55% top rate. What does this mean for your estate plan?

The rules for estate planning are very favorable in 2011 and 2012. This two-year window should be a reason to take action now. Congress will need to revisit the estate tax in two years, and the desire to raise revenue may lead a future Congress to limit or take away some tax-saving strategies that are currently sanctioned. Here are some key points to keep in mind:

For married couples with large estates, “credit shelter” planning is more valuable than ever. Credit shelter planning is designed to make sure that married couples take advantage of both of their respective estate tax exclusions. New rules make the exclusion “portable” between spouses. In other words, a deceased spouse can pass on his or her unused exclusion to the surviving spouse.

- This could benefit modest estates, and reduce tax costs for procrastinators and couples who fail to plan. However, it may not be wise to rely on the portability rules just yet, because they are scheduled to lapse after 2012.
- In order to get the benefit of portability, an estate tax return must be filed, even if the estate would not normally be subject to estate tax.
- In addition, portability has risks. After the exclusion is passed on to a survivor, it could still be lost due to remarriage, or changes to the survivor’s estate plan.
- For larger estates, it still makes sense to proactively create a credit shelter trust at the first death. A credit shelter trust is more effective because it removes future asset growth from the survivor’s taxable estate and assures that the exclusion will be used as intended.

To make credit shelter planning work, you need more than a good document. It’s critical to assure that asset ownership and beneficiary designations are “in sync” with the directions in your will or trust.

In 2011 and 2012, the lifetime gift exemption is increased to \$5 million. For high-net-worth families, this opens up remarkable planning opportunities for business-succession and wealth-transfer planning. Attractive strategies to consider might include:

- Grantor retained annuity trusts (GRATs)
- Life insurance trusts funded with income-producing assets
- Valuation-discount planning
- Charitable lead trusts
- Sales to younger generations, including sales to grantor trusts

“Generation skipping” planning could be smarter than ever.

- Generation skipping is not about skipping your kids – it’s about skipping a generation of tax. Children can still be the beneficiaries of a generation-skipping trust but have the opportunity to pass trust assets to future generations without estate tax.
- Life insurance can be used to “supersize” a multigenerational trust.

Planning for *state* estate taxes is more important than ever.

- More than 20 states impose their own estate or inheritance tax. Some also have a gift tax.
- The threshold for states is often much lower than the federal threshold. States often begin imposing their own estate taxes at \$675,000 or \$1 million.
- For large estates, state taxes can add an additional 10% to 15% on top of any federal tax.
- When the state exclusion is lower than the federal exclusion, married couples face special planning challenges. Be sure to consult an experienced local attorney, because planning options and strategies can vary considerably from state to state.

This is a good time to review existing life insurance policies.

- You should include both policies that are included in the taxable estate and those held “outside” the taxable estate (within an irrevocable life insurance trust).
- When reviewing life insurance needs, remember that the \$5 million exclusion level is only effective through 2012; prospects for its extension are uncertain.

It makes sense for families to give more attention to non-tax issues, including long-term trust planning and family wealth education. In your discussions with your Financial Advisor and your estate planning attorney, consider:

- Higher exemptions mean your children and grandchildren will receive more. How do you want this wealth to affect their lives?
- What would have a more positive impact on your family – a lump sum inheritance or a lifetime of supplemental income?

Remember that trusts are not only for tax planning. Depending on your objectives, ongoing trusts can be used to guide investment management, set spending guidelines, provide some degree of asset protection, promote charitable goals and perpetuate your legacy and values.

Flexibility for estates of those who died in 2010

The act provides some flexibility for the estates of individuals who died in 2010. Executors will be permitted to select either:

- The “old” 2010 rules, which repealed the estate tax for one year, but permitted only a limited “step up” in cost basis at death, or
- Retroactive application of the new rules, with a \$5 million exclusion and an automatic basis adjustment for all assets

Very large estates would most likely prefer the former; estates under the \$5 million threshold might prefer the latter.

For the estates of individuals who died during 2010, the due date for filing returns is extended until Sept 17, 2011 (nine months after the date of enactment).

Review your strategies today

These increased exemption levels for estate, gift and generation-skipping tax – even temporarily – represent a remarkable planning opportunity. It’s important to take a step back and ask yourself what you and your family want your estate plan to accomplish. Under this new law, the opportunities for wealth transfer planning are greater than ever. Talking with your Financial Advisor and estate planning attorney can help you narrow – or expand – the possibilities and choose the kind of trusts and other wealth-transfer vehicles that best suit your goals.

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Any estate plan should be prepared and reviewed by an attorney who specializes in estate planning and is licensed to practice law in your state. Please consult your legal advisors to determine how this information may apply to your own situation. Whether any planned tax result is realized by you depends on the specific facts of your situation at the time your tax preparer submits your return.

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