

## What shall we do with a drunken sailor . . .

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I was a child when I last sang the old sea shanty "Drunken Sailor", but its first line popped into mind when I read a summary of the recent federal tax legislation signed into law December 17, 2010. This is the "Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010".

Congress's generous give-away in this legislation of extremely favorable gift, estate and GST tax benefits for 2011 and 2012 gave me a festive feeling, as though we all can be drunk and merry for the next two years under the influence of these tax laws.

This recent legislation increases the federal exemption for estate, gift and generation-skipping tax (GST) purposes to \$5.0 million with an estate, gift and GST tax rate of 35%. There also is portability of each spouse's exemption for married couples. No indications point to -- nor can anyone rationally predict -- what Congress will do with this exemption and tax rate at the end of this two-year party.

As to immediate tax planning, it is an easy and straightforward proposition during 2011 and 2012 that a client take advantage of the \$5.0 million exemption simply by either giving away \$5.0 million as a gift, or by dying. But, realistically these are not suitable options for most clients.

Not suitable, as many clients during 2011 or 2012 neither want to give away \$5.0 million merely to join this party nor die. Thus, this newsletter sets forth an array of alternative

planning options clients can consider for 2011 and 2012. These alternatives, compared to making outright gifts or dying during 2011 or 2012, inevitably are on the more complex end of the estate planning spectrum.

### Estate Tax Planning

**An *Inter-Vivos QTIP Trust*.** Married couples need to make sure their estate plan enables either spouse to own, or be deemed to own, at least \$5.0 million of property if death were to occur during 2011 or 2012, against which to apply the \$5.0 million exemption.

Regardless of which spouse dies first, this inter-vivos QTIP trust enables *either spouse to be deemed* the owner of the \$5.0 million QTIP trust, helping to ensure that the \$5.0 million QTIP trust property applies against the first deceased spouse's estate exemption.

**Elderly Parents' Planning.** Clients should review their parents' estate planning setup, making certain each of their parents has enough property to take advantage of the \$5.0 million estate exemption (with the use of the above inter-vivos QTIP trust if necessary).

These parents also can implement GST trusts to take advantage of the \$5.0 million GST exemption for 2011 and 2012. With use of this GST trust, a client can be included as a beneficiary and trustee of his parents' GST trust but with the trust designed so that its value later is not includible in the client's own estate at death for estate tax purposes.

As an example of the various creative responses to this exemption-rich environment, one tax commentator has suggested having a child loan his elderly parents \$5.0 million with the parents thereafter making \$5.0 million GST trust gifts secured by a written promissory note. The note will be a liability against the value of the parents' estate if death occurs while the note remains outstanding.

### Gift Tax Planning

Except for the first option discussed below, the following gifting options are for clients who wish to take advantage of the \$5.0 million gift/GST exemption during 2011 and 2012 but frankly do not wish to give away a \$5.0 million gift.

**Gift-Splitting for Both Spouses.** If one spouse does not have \$5.0 million of property for use against the gift or estate tax, that spouse can split a lifetime gift with the other spouse. This can enable the spouse who is actually making the gift to use a \$10 million combined gift exemption.

**Gift of a QTIP Income Interest.** This gift option is for a surviving spouse who presently is a beneficiary under his or her late wife's or husband's QTIP trust. Here, the surviving spouse can give to the remainder beneficiaries a small (such as 1%) income interest in the QTIP trust. These are the remainder beneficiaries named in the deceased spouse's QTIP trust, typically the children.

Under Code Section 2519 of the tax law, the surviving spouse giving away a 1% QTIP income interest (thus, retaining the continuing right to 99% of the income interest) is deemed to make a gift of 100% of the QTIP trust corpus.

But, the trust corpus itself remains in the QTIP trust for the lifetime of the surviving spouse to continue providing her with the 99% income interest until her death. There can still also be an encroachment of corpus for the surviving spouse under the terms of the QTIP trust, if necessary.

To be more technical, this QTIP gift planning will likely involve first dividing the QTIP trust in some cases so that one QTIP share has a trust corpus of \$5.0 million for purposes of this Section 2519 gift planning.

**Spousal \$5.0 Million Gift in Trust.** A married spouse can make an irrevocable trust gift of \$5.0 million with his or her spouse being a beneficiary of the trust (along with other family members if desired). This is an intra-family gift designed to take advantage of the \$5.0 million gift exclusion.

The beneficiary spouse can also hold a limited power of appointment under the terms of the trust to appoint, should he/she ever desire, the trust property to the spouse who creates this trust (called the "settlor" of the trust) or to the children.

This \$5.0 million gift in trust can be further enhanced by allowing the spouse who creates the trust also to be a beneficiary (thus, called a self-settled trust), if the trust is created with a trustee who resides in certain other states that allow this type of self-settled trust (not Georgia). Alaska, for example, is a good choice based on using similar structure that was the subject of IRS Letter Ruling 200944002.

As an aside, a settlor in Georgia, for example, can create this Alaska trust and still reside in Georgia. The kicker is that the trust must include an Alaskan trustee, typically a corporate trustee located in Alaska.

**Qualified Personal Residence Trust.** This is an option for clients who are not interested in the above planning options. Even in addition to the numerous other benefits of a qualified personal residence trust (a QPRT), a client can retain a term interest in his her residence and make a remainder gift of the residence so as to apply a portion or all of the \$5.0 million gift exemption to the remainder interest.

### GST Planning

**GST Gift to an Inter-Vivos QTIP.** This is a way to apply the \$5.0 million GST exemption, but

effectively keep the property in hand between both spouses. This involves using an inter-vivos QTIP trust into which one spouse transfers \$5.0 million and allocates \$5.0 million of his GST exemption. The trust will be for the benefit of the other spouse for her lifetime and for the children thereafter, with the other spouse having a limited power of appointment that includes the donor spouse and the children, etc.

### Tax Policy Commentary

The 2010 tax act was driven by Congress's effort to stimulate the economy, not with a focus on revenue. The reality of Congress ultimately having to address tax legislation with a perspective on revenue may likely have a post-party sobering effect.

The information below about the cost of this recent 2010 tax legislation helps provide a relative framework of the cost of this party, and whether it will (or can) continue.

According to estimates from the Joint Committee on Taxation, the temporary increase in the estate exemption to \$5.0 million with a tax rate of 35% for 2011 and 2012 (including

the 2010 election to opt in or out of the estate tax vs. carryover basis) is projected to have a revenue loss of \$68 billion. Among the other provisions of the 2010 tax act is the retention of the Bush income tax rates that the Joint Committee projects will result in a revenue loss of \$186 billion. Taking into account all of the provisions of the 2010 tax act, the projected revenue loss is \$857 billion.<sup>1</sup>

The Joint Committee estimate of the revenue loss -- had there been a repeal of the estate tax continuing from 2009 up through 2018 -- would have been \$669 billion (for the period 2009 through 2018).<sup>2</sup>

For a perspective on the size of these revenue numbers, the 2010 federal expenditure for Social Security retirement, survivors and disability payments was \$702.5 billion; the 2010 expenditure for the IRS was \$12.1 billion; the FBI \$7.7 billion; National Park Service \$2.7 billion; Fish and Wildlife Service \$1.6 billion.<sup>3</sup>

Enjoy the party, while you can.

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<sup>1</sup> <http://jct.gov> [publication JCX-54-10]

<sup>2</sup> <http://jct.gov> [publication JCS-1-08]

<sup>3</sup> <http://budget.gov> [from the Office of Management and Budget fiscal year 2011 budget]