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ESTATE AND TAX PLANNING

Important Changes for Estate Planning Clients

As we prepare to move into the latter part of 2012, this Report will provide guidance on recent developments affecting estate and tax planning.

IRS Issues Temporary Regulations Governing Portability

Portability was introduced under the 2010 Tax Act which granted a surviving spouse the opportunity to use his or her deceased spouse's unused Federal estate tax exemption. The benefit of "portability" is that if the first spouse to die fails to make full use of his or her exemption (currently $5 Million), the surviving spouse can inherit the deceased spouse's unused exemption and add it to his or her own exemption, effectively ensuring the amount the couple can shelter from estate tax is $10 Million, or twice the Federal exemption. As this provision was to be effective for estates of decedents dying after 2010 and before 2013, its application in 2013 and later years is presently uncertain.

Temporary Regulations issued in June, 2012 require the estate of the first spouse to die to elect "portability" by filing a timely Federal estate tax return. The last timely filed return, including extensions, will control. If a decedent's estate does not wish to make the portability election, the executor must make an affirmative statement to that effect on the estate tax return. Estates that must file an estate tax return are deemed to have not elected portability if they fail to file a timely return. The election, once made, is irrevocable. It is worth repeating that it is essential to file, *even if no tax will be due in the estate of the first spouse*, in order to preserve the exemption.

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Ruling May Affect Tax Benefits for Same-Sex Couples

The U.S District Court for the Southern District of New York has ruled that same-sex couples can take advantage of the estate tax marital deduction. Edith "Edie" Windsor and Thea Spyer registered as domestic partners in New York City in 1993, and married in Canada in 2007. Spyer died in 2009, and her assets were left to Windsor. After paying applicable Federal estate taxes, Spyer's estate sought a refund of the amount paid, asserting the availability of the Federal estate tax marital deduction for amounts passing to Windsor.

Spyer's claim was that the provisions of Section 3 of the Defense of Marriage Act (DOMA) violated the equal protection clause of the U.S. Constitution. As Section 3 defines "marriage" under Federal law as a legal union between one man and one woman as husband and wife, such definition would apply under the Internal Revenue Code and effectively disallow the marital deduction for same-sex couples. The Court found the DOMA provisions unconstitutional under the "rational basis" standard which requires that a law have a rational basis for its classifications to withstand an equal protection clause challenge.

On July 16, 2012, lawyers filed a petition on behalf of Edie Windsor asking the Supreme Court to review her case, thus bypassing the Second Circuit Court of Appeals. Earlier this summer, the Obama administration asked the high court to review two other cases challenging DOMA's constitutionality. With Windsor's petition, there are now three cases—from three gay marriage states, California, Massachusetts and New York—that could challenge DOMA in the Supreme Court as early as next Spring, if the court consents to hear them. Further, on July 31, 2012, a Federal judge in Connecticut ruled that the provision in the 1996 Defense of Marriage Act violates the Fifth Amendment right to equal protection. The ruling came in the case of six married same-sex couples and a widower who sued after being denied various Federal income tax and other governmental benefits.

If the DOMA provision is invalid, several other Federal tax provisions that provide benefits to married persons would likewise become available to same-sex married couples. These include (a) the Federal gift tax marital deduction, (b) joint income tax return filing rates and permissions, (c) favorable "stretch" and rollover provisions for IRAs and other qualified retirement plan distributions to a surviving spouse, and (d) portability of the Federal estate tax exemption between spouses. Other Federal law provisions outside of the Internal Revenue Code that turn on marital status may also apply, including those relating to employment benefits.

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Various States Update Decanting Statutes

Decanting is the term generally used to describe the distribution of trust property to another trust pursuant to the Trustee's discretionary authority to make distributions to or for the benefit of one or more beneficiaries. New York was the first state to allow the effective "rewriting" of an irrevocable trust by permitting trust assets to be appointed or "decanted" to another trust when it enacted EPTL Section 10-6.6 in 1992. In 2011, New York moved back into the forefront of states with advantageous statutes allowing decanting from irrevocable trusts with a bill that enacted an improved decanting statute. A number of states have followed suit.

The New York legislation has modernized and expanded New York's statute to permit decanting under a broader range of circumstances. Under the new statute, a Trustee may decant even if the Trustee does not have unlimited discretion to distribute principal to one or more beneficiaries, provided there is some ability of the Trustee to distribute principal. The ability to modify certain terms of an irrevocable trust by decanting into a new trust is enormously useful as it allows Trustees to take into account changed circumstances, to correct mistakes and to take advantage of certain beneficial tax planning.

While states such as New Jersey rely solely on the common law to regulate the decanting of trust assets, decanting legislation has been enacted or is pending final approval in Ohio, South Dakota, Virginia, Kentucky, Rhode Island and Illinois. Michigan, Alaska and South Carolina are also on the verge of passing or liberalizing decanting statutes.

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As always, we recommend that clients review their estate plans periodically and/or whenever a significant life event occurs (e.g., birth of a child, death of a spouse, purchase of new home, change of state of residence, etc.). Individuals with substantial amounts of wealth or with closely-held businesses may consider whether to take further advantage of the current $5 Million gift tax exemption (or actually $5.12 Million as this exemption has been indexed for inflation), which will expire absent further Congressional action at the end of 2012. The uncertain legislative environment is still an ideal time to consider lifetime gifts because some property values are depressed, interest rates are at an historic low and valuation discounts may not be available in the future.

Reid Glynn, LLP aims to keep you abreast of the ever-changing tax laws. Please do not hesitate to contact us with any questions that you might have or if you would like to discuss your estate plan in light of this Report.

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Announcements

Reid Glynn is excited to announce our relocation to 405 Park Avenue (at 54th Street) in August, 2012. All telephone, fax and email contacts remain the same.

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