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Navigating the Estate Planning Pitfalls Created by the Taxpayer Relief Act of 2012

By Richard M. Morgan & Loraine M. DiSalvo

As the bar for "wealth" moves north many individuals we meet are lulled into thinking that complex estate planning strategies are reserved for those other people with greater wealth than they. With the new $5MM exclusion amount (indexed for inflation) plus portability of a deceased spouse's exclusion to a surviving spouse, which may allow a married couple up to an effective exclusion of more than $10MM – many families are comfortable that the individual assets and businesses in their estate will be able to pass along to their families unscathed. While this new ceiling may be sufficiently high enough to exceed their net worth, it's not a complete game changer. You see, the same estate planning and wealth transfer considerations that were important before will remain important under the 2012 Tax Act. Let me try to break it down for you by wealth levels.

For the Moderately Wealthy (Well Under $5MM)

Most of you will no longer be at any risk of paying wealth transfer taxes because of the high estate tax basic exclusion amount, even without using portability. However, there are still potential problems and issues that should be addressed with proper estate planning. Use this checklist of special circumstances to determine whether you are at risk:

1. **Do you have a desire to protect the assets you pass on to your loved ones?**
   With proper planning, you can protect the assets you eventually pass on to your loved ones from their possible future problems, including predators, creditors, spouses in divorce situations and possible estate taxes when any remaining assets pass on at your loved ones' passing (e.g., passing assets at your child's death to your grandchildren).

2. **Do you have a blended family?**
   A bended family is one where either or both members of a couple has children from prior relationships, or one member has children from a prior relationship and the other has no children but wishes to benefit other family members, friends, and/or charities rather than leaving all assets to the other member's descendants.

3. **Are you part of a long-term non-married couple?**
   This would include either same-sex or opposite sex, and with or without children involved.

4. **Do you have any special needs beneficiaries?**
   This would include beneficiaries who suffer disabilities, are elderly, or otherwise have a heightened need for protection and special planning, such as beneficiaries with substance abuse issues or even simply a demonstrated tendency to make very bad decisions in general. These beneficiaries may or

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may not need to maintain eligibility for needs-tested government benefits, but special planning and trusts are often highly beneficial if not absolutely necessary.

5. **Are there any situations which may create a heightening risk of post death dispute?**
   This would include disharmony between family members, family members not being treated the same, litigious family members, or the existence of special assets such as valuable land, unique assets, or a family business.

   Note: a blended family, no matter how harmonious it may seem, nearly always creates a heightened risk of a post death dispute, since the death of a central figure may often lead to the dissolution of previously harmonious relationships as assets begin to be dealt with and different interests come into direct conflict. In addition, long-term non-married couples also frequently fall into this category, since the members of the couple are not each other's heirs, and the legal heirs may or may not feel friendly towards or wish to help the surviving member after one member's death.

6. **Do you have a desire to provide significant charitable gifts or bequests?**
   This may include either your desire to benefit a school, place of worship or other non-profit organization, or your desire to give your loved ones the gift of being able to give to the charities of their choice.

   If you answered "yes" to any of these questions, then careful and more sophisticated planning is still needed, just as it was before the 2012 Tax Act.

   If you answered "no" to the questions above then a truly simple estate plan may actually be a good, appropriate, and effective choice.

Still, you should ask yourself how much you care about ensuring that all goes as planned after your passing. If you really care about what happens, you should still seek the assistance of an experienced and competent estate planning attorney, like the attorneys at Morgan & DiSalvo. For those who answered that getting a will done is on my to-do list and simply getting it done and off my to-do list is good enough, many options currently exist to get your will done on a free or very inexpensive basis. However, before you go online to download a do it yourself (DIY) will, please be aware that simple, DIY, solutions are not always that easy to apply or operate. In other words, simple in creation does not necessarily mean simple and effective in implementation.

In our own practice we encountered a young married couple whose LegalZoom-prepared Wills provided for the one child they had at the time they did the Wills, but not for the second child they had after they had signed the Wills. Under Georgia law, while their Wills would still remain in effect as to the benefits provided to the surviving spouse and the first child, the second child (along with any additional children they might have had) would receive a share of the probate estate of the first spouse to die as if that spouse had not had any Will - not at all the desired or expected result.

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We have also seen a number of Wills prepared by attorneys who were not estate planning specialists over our years in practice. While some of these are okay, others don't contain desirable provisions such as self-proving affidavits or broad powers for the Executor, and very few have ever provided all of the provisions which you usually want to see in order to ensure that the Will and any trusts it might create work as well and as beneficially as possible. Problems do not always arise from what a legal document, like a will, states but from what it fails to state.

For Potentially High Wealth Clients (Currently at or above $3.5MM for a single person or 7.0MM for a married couple)

Individuals who may currently be below the basic estate tax exclusion amount level, but who have the potential for significant wealth increases in the future and are still at risk of one day being subject to wealth transfer taxes, should still take wealth transfer tax reduction planning very seriously.

While you may opt to go for simpler options over all others, your intended beneficiaries will generally be much better off if you work with high end, estate and tax attorneys and other high end wealth advisors from the start, to properly consider and structure your estate plans.

The same planning considerations apply to this group as applied to the moderately wealthy group (discussed above) but this group will need to more seriously consider the need for modifying their planning structure to both reduce or eliminate any possible future wealth transfer taxes and protect the assets you will eventually pass to your loved ones from possible future problems, including potential predators, creditors, and spouses in divorce situations.

For both this group and for the high wealth group (discussed below), two more special planning situations may arise. These situations include those married to a non-U.S. citizen and those who either live in or own real estate in a state which has its own inheritance tax. Georgia and Florida do not have a separate inheritance tax.

In addition, for those in this group who are high income earners , income tax reduction planning during your lifetime may help to reduce the significantly higher income and new Medicare taxes under the 2012 Tax Act.

For High Wealth Clients (Currently well over $5MM for a single person or well over $10MM for a married couple)

If you are a high wealth individual or family, you probably already realize that you will end up having wealth transfer tax issues despite the higher basic exclusion amounts and portability which are provided by the 2012 Tax Act. You should continue to work with your estate and tax planning attorney as well as other advisors to prepare. You may also be a candidate for such potentially beneficial estate planning techniques as using GST tax exempt long-term or "dynasty" trusts, trusts which are structured as "grantor" trusts for income tax

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purposes, short- term GRATs, valuation discount planning, and other strategies that may be on the Congressional chopping block in the near or mid-term future. Even if you fully used your gift tax exclusion amounts in 2012, you may still have room to make taxable gifts in the future since the gift tax exclusion amount is now indexed for inflation. Attorneys skilled in and knowledgeable about estate and tax planning techniques for wealthy clients can produce a lot of benefit from a little exclusion amount.

Just as with the potentially high wealth individuals discussed above, income tax planning may now be even more important for you than it was in the past, and you should be working with your advisors on an annual basis to help prepare for these issues. With the top ordinary income tax rate at 39.6% + the new 3.8% Medicare tax on (passive) investment income + state income tax, you could be closing in on a marginal tax rate close to 50%. This will not be a pleasant thought for anyone that will be looking at these new higher tax rates.

Rest assured, a little time spent with your attorney and other professional advisors now can go a long way towards carrying out your desires as you intend, while also making your life less stressful and taxing.

This article merely highlights some of the reasons why sophisticated estate planning may still be an appropriate choice for even moderately wealthy individuals despite the new exemptions of the 2012 Tax Act. Every family situation continues to be unique and we'd encourage you to contact us at 678-720-0750 or email sollila@morgandisalvo.com if you'd like to schedule time to discuss the implications for your family.