



## What We Need to Know to Plan an Estate Today (and Tomorrow)

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### The Rules Have Changed and What Used to Be Right May now be Wrong!

With the larger federal exemption of \$5,430,000 in 2015 (and scheduled to increase with inflation), the “permanence” of federal portability<sup>1</sup>, the Tennessee inheritance tax exemption of \$5,000,000 in 2015, and the sunset of the Tennessee inheritance tax come 2016, planners have more decisions to consider with clients. In the past, potential transfer tax costs often drove narrow decisions as to the types of planning and the forms of documents needed.

For many clients, our current tax planning is to minimize *income* taxes, rather than transfer taxes. If a married couple with a net worth under \$9,000,000 (including well under) comes to us for estate planning, our primary concerns are (1) availability of a disclaimer to take advantage of the Tennessee exemption should both deaths occur in 2015, (2) proper beneficiary designations on retirement accounts, (3) making certain to elect portability on a timely filed Form 706 on the first spouse's death, and (4) obtaining the best income tax results.

Larger exemptions make wills and other planning documents that leave the estate outright to the surviving spouse (a simple “I Love You” will) the usual choice for most clients, where there are no other considerations beyond ensuring that there is not a taxable estate at either death.

Where the married couple has a possible concern about federal estate tax or Tennessee inheritance tax, a will that leaves all to the surviving spouse may also contain a provision for a contingent disclaimer that allows the

surviving spouse to use a disclaimer to fund a trust which would use the decedent's federal estate tax exemption and/or Tennessee inheritance tax exemption through use of a bypass trust and a Tennessee marital gap trust. The contingent disclaimer allows for post-death planning based on the situation with assets and tax laws at that time.

Many older wills and will forms are outdated, and *indeed may be harmful*. Given the larger federal estate tax exemptions, it is important to consider the impact of formula clauses in wills tied to the federal estate tax exemption. A will which leaves the entire amount of the federal estate tax exemption in a bypass trust may considerably overfund that trust. For example, for a couple where the husband had an estate of \$3,000,000 and the wife has an estate of \$2,000,000, there may be no reason to fund a bypass trust at all.

Remember that there is a step up in basis for federal income tax purposes for most assets passing through an estate. The bypass trust was designed to bypass the surviving spouse's estate. This was a wonderful idea when avoiding transfer taxes was the concern. However, this also bypasses a stepped up basis on those assets at the death of the surviving spouse. A formula clause maximizing the fund-

ing of the bypass trust would not only be unnecessary if timely elected portability would preclude estate taxes at the surviving spouse's death, but would do harm by eliminating the second step-up in basis.

Our new tool, a Tennessee Community Property Trust, provides an excellent vehicle for providing a full step up<sup>2</sup> in community property assets where the surviving spouse may wish to take advantage of the full step up by selling assets after the first spouse's death. Under Section 1014 of the Internal Revenue Code, where property is held as tenants by the entirety or as tenants in common without right of survivorship, there is a step up in basis upon death only for the share owned by the deceased owner. But, where the property is held as community property, under 1014(b)(6), at the death of the first spouse, both spouses' interests will be eligible for a stepped up basis to date of death value at the first spouse's death.

### New Issues with Filing a Form 706

Parties to a pre- or post-nuptial agreement should agree to permit the use of the deceased spousal unused exclusion (DSUE), and provide for which party pays for the filing of Form 706. Because of the expense of preparing Form 706, and the time required to do so, a decision whether to elect portability needs to be made early in the administration of a decedent's estate. Anytime there is a surviving spouse, the executor should file Form 706 unless there is a conscious and documented decision not to do so. However, Congress may change the law again, so planners need to consider whether current documents need to be re-drafted to work if portability were repealed or significantly restricted.

### Compressed Income Tax Rates for Trusts and Estates

Since estates and trusts are at risk of additional income tax above \$12,300 of taxable income in any year, planning as to the distribution of income out of the estate or trust to beneficiaries, or otherwise managing assets, should occur as a specific decision at the beginning of the administration of an estate, or, in the case of a trust, at the drafting stage and as a specific decision at least annually thereafter.

### Gifting

With the higher transfer tax exemptions, families have far more flexibility in use of gifting for inter-generational wealth planning. However, with the higher exemptions, it is easy to become careless with filing gift tax returns. Timely and complete filings for gifts above the annual exclusion (\$14,000 per donee in 2015) or for split gifts, remain important. But remember, life insurance continues to provide tax-free build up in the policy and income tax free proceeds so for now it continues to furnish protection from the increasing income taxes. Also, be aware that a lifetime gift only carries over the donor's basis and misses the stepped up basis at the donor's death.

### Remember.

#### We're Still Planning for Humans

Regardless of what happens with the exemptions, Tennessee or federal, the human reasons for using trusts—protection from divorce, creditors or health issues, providing professional management, and assuring that a share passes to children—still remain strong reasons to consider the use of trusts in planning. ■



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(Endnotes)

<sup>1</sup> Portability is a procedure that allows the surviving spouse to use any portion of the predeceased spouse's federal estate or gift tax exemption, but not generation-skipping exemption.