

Don B. Stahr, J.D., C.P.A.  
William M. Cobb, J.D., C.P.A.  
Jack D. Flesher, J.D.  
R. Chris Robe, J.D., C.P.A.  
Eric J. Larson, J.D., C.P.A.★†  
Robert M. Hughes, J.D., LL.M.★  
Gregory L. Franken, J.D., C.P.A.  
Hellen L. Haag, J.D., LL.M.  
Scott D. Jensen, J.D.  
Brian A. Turney, J.D.◆  
Gregg C. Goodwin, J.D., C.P.A.  
Eric S. Parkhurst, J.D.◆

# BEVER ◆ DYE

LC, ATTORNEYS AT LAW

Epic Center, 301 N. Main St., Suite 600  
Wichita, Kansas 67202-4806

Telephone 316-263-8294  
Fax 316-263-3142  
www.beverdye.com

Eric V. Calvert, J.D.  
Charles W. Mangrum, J.D., LL.M.★  
Danielle K. Schulte, J.D.  
Laci L. Boyle, J.D., LL.M.

Jeffrey D. Arbuckle, J.D., C.P.A.  
Special Counsel

★Also licensed to practice in Texas.  
†Also licensed to practice in Nebraska.  
◆Also licensed to practice in Oklahoma.

## CLIENT MEMORANDUM

**TO:** Clients of Bever Dye, LC

**DATE:** March 9, 2011

**RE:** Changes to Estate, Gift and Generation-Skipping Transfer Tax Laws

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On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "2010 Act"). In addition to extending the 2001 and 2003 income tax "cuts" until the end of 2012, the 2010 Act made some significant changes to the estate, gift and generation-skipping transfer ("GST") tax laws. This memorandum will discuss some of the pertinent changes to these transfer tax laws which could impact the estate plans of some of our clients.

The 2010 Act retroactively reinstated the federal estate tax for 2010, which had been repealed under prior law. Estates of individuals who died in 2010 were basically given the option (i) to accept the reinstatement of the federal estate tax, which would allow the income tax basis in the decedent's assets to become equal to the fair market value of such assets as of the decedent's date of death ("Basis Step-Up"), or (ii) to pay no federal estate tax, which would allow for only a limited Basis Step-Up for inherited assets. For 2011 and thereafter, the federal estate tax continues in effect with unlimited Basis Step-Up for the assets inherited from a decedent.

Under the 2010 Act, the federal estate, gift and GST tax exemptions (the "Exemptions") will be \$5 million per person for 2011. The Exemptions will be increased somewhat for inflation in 2012, but will be no less than \$5 million. However, the 2010 Act expires at the end of 2012 unless Congress takes further action, and the Exemptions will then be reduced to \$1 million per person beginning in 2013. (The GST tax exemption will be increased somewhat for inflation.)

Under the 2010 Act, the estate, gift and GST tax rates are 35%. However, those rates are scheduled to increase to 55% (60% for some) in 2013 upon the expiration of the 2010 Act.

You may have also read that the 2010 Act allows a surviving spouse to inherit the unused estate tax exemption of the first spouse to die ("Exemption Portability"). Some may think that this simplifies estate planning for all but the most wealthy taxpayers. However, relying on Exemption Portability may result in missed planning opportunities that may only be available at the death of the first spouse. Also, like the other estate, gift and GST tax law changes, the Exemption Portability law expires at the end of 2012. Therefore, for these reasons, it is probably best not to rely on Exemption Portability in lieu of traditional estate planning.

As you can see, while the 2010 Act made some positive changes to the estate, gift and GST tax laws, these are only short-term changes. As a result, you should be careful in relying on these temporary changes to the tax law when considering your estate planning.

Perhaps the most important reason for this memorandum is to make our clients aware that their estate plan could be negatively impacted by the changes in the federal estate, gift and GST tax laws. Some of our clients made changes to their estate plans last year to address problems related to the temporary repeal of the federal estate and GST taxes. However, the changes made to address those problems may not fully address the problems created by the 2010 Act. For your reference we have attached a couple of examples of how an individual's estate plan could be affected by such changes.

Different sized tax exemptions can result in a significant shift in wealth depending upon when someone dies, and the effective rate of estate and GST taxes can result in significant changes in the amount each beneficiary receives. Therefore, it is recommended that our clients have their estate planning documents reviewed to ensure that they reflect their wishes no matter what the exemptions and tax rates may be at their deaths.

Obviously, if there are potential problems with our clients' estate plans due to temporary changes to the federal estate tax and GST tax laws, we want to ensure that those problems are resolved. However, we will not undertake a review of a client's estate plan unless the client requests such a review. Therefore, if you would like us to review your current estate plan in light of the 2010 Act, we ask that you let us know. If we do not hear from you, we will assume that you have decided not to have us review your estate plan, and we will take no action regarding your estate plan.

Finally, keep in mind that these temporary changes provide significant planning opportunities in 2011 and 2012. For example, as mentioned above, the lifetime gift tax exemption has been increased to \$5 million for 2011 and 2012. This is a dramatic change from prior law where the lifetime gift tax exemption was capped at \$1 million. Those of our clients

who are in a position to make large gifts should seriously consider using some or all of their increased gift and GST tax exemptions in the event this opportunity no longer exists after 2012.

We encourage you to call us if you have questions about your estate plan in light of the law changes resulting from the 2010 Act.

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*The information contained herein is general in nature and based on authorities that are subject to change. It is not intended and should not be construed as legal advice or an opinion provided by Bever Dye, LC. This material may not be applicable to or suitable for specific circumstances or needs and may require consideration of nontax and other tax factors. Please contact Bever Dye, LC professionals prior to taking any action based upon this information.*

**EXAMPLES SHOWING NEGATIVE IMPACT OF 2010 CHANGE TO FEDERAL ESTATE, GIFT AND GENERATION-SKIPPING TAX LAWS ON ESTATE PLANS**

**Example 1**

The estate planning document contains a clause that directs the personal representative to fund a credit shelter trust (the "Family Trust") with as much property as is permitted without triggering any federal estate tax, with any remaining property to be distributed to a separate marital trust share (the "Marital Trust").

Under this scenario, if the decedent's estate is under \$5 million, and death occurs in 2011 or 2012, the personal representative will be required to fund the Family Trust with the entire estate of the decedent because the entire estate can now be distributed to the Family Trust without triggering any federal estate tax. In that case, if the surviving spouse only had a beneficial interest in the Marital Trust and had no beneficial interest in the Family Trust, then the surviving spouse would effectively be disinherited by the decedent.

**Example 2**

The estate planning document first sets aside the decedent's remaining generation-skipping tax exemption amount in a separate trust for the decedent's grandchildren, with the remainder of the decedent's estate to pass to the decedent's children.

If death occurs in 2011 or 2012, and the decedent's estate is less than \$5 million, the grandchildren will now receive the entire estate, and the children will receive nothing.