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ESTATE TAX PLANNING, UNINTENDED CONSEQUENCES

Since the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the amount that an individual can protect from federal estate taxes (the "unified credit") has steadily increased. In 2008, the unified credit was $2,000,000 per individual. As of January 1, 2009, the unified credit has increased to $3,500,000. Under the current law, beginning on January 1, 2010, the federal estate tax is suspended for one year. Then, on January 1, 2011, the unified credit is scheduled to return to $1,000,000.

Because property left to a surviving spouse is not subject to estate taxation at the death of the first spouse, some individuals have implemented an estate plan leaving an amount equal to the unified credit to beneficiaries *other than* their spouse and leaving the balance of their estate to the spouse, or in a trust for the benefit of the spouse. This plan enables non-spouse beneficiaries to enjoy the benefit of a portion of their inheritance at the death of the first spouse rather than having to wait until both spouses have died. Provided that the trust for the surviving spouse meets certain statutory requirements, this planning may also eliminate federal estate tax liability at the first death.

With the most recent increase in the unified credit, and the suspension currently scheduled to be implemented in 2010, there may be unintended consequences to such an arrangement.

For example, John and Mary are each married for the second time. They have no children together but each has children from their first marriage. Each wants to provide for the other should he/she pass away first. However, if they are the first to die, they also do not want their own children to have to wait until their spouse's death to receive an inheritance. Their plans provide that, at the first death, an amount equal to the federal unified credit of that spouse's estate is to be distributed to that spouse's children. The balance of his/her estate will fund a trust for the benefit of the surviving spouse for life, after which, whatever remains in the trust will be distributed to the children of the first to die.

When John and Mary's plan was created in 2002, they each separately owned property with a total value of $2,000,000. At that time, the unified credit was $1,000,000. At the death of the first of them, they each intended that $1,000,000 of that person's assets would be distributed to that spouse's children. Their expectation was, and is, that the remaining $1,000,000 would fund a trust for the survivor until his or her death, when the balance remaining would be distributed to the children of the first to die. Because the amount to be distributed to the children, at the first death, is defined by the federal unified credit, now $3,500,000, if either John or Mary die this year, his/her entire estate will be distributed to his or her children, leaving no property remaining to fund the trust for the survivor.

Any estate plan which uses the federal unified credit as a measuring stick for the distribution of property to beneficiaries will suffer similar consequences.

Fortunately, if this situation sounds like yours, or you are not sure, you can take steps to avoid this unintended consequence of the increase to the unified credit. It starts with having your estate plan reviewed immediately. Even if you do not believe that you are affected by the increase in the unified credit, we at Berwitz & DiTata LLP strongly encourage our clients to review their estate plans regularly, at least every three (3) years. This way, you can be sure that changes that may have occurred in the law, or in your life, will not unintentionally affect your estate plan.