GADSDEN & SCHNEIDER
WOODWARD LLP

LAW OFFICES

CHRISTOPHER H. GADSDEN
PAM H. SCHNEIDER (also admitted in NY)
W. STEVEN WOODWARD
TRACY BLAKE DeVLIEGER
KIM V. HEYMAN (also admitted in NY)
LISA M. RHODE
BENJAMIN K. RODGERS (also admitted in NJ)
TIMOTHY D. MILES (also admitted in NJ)

201 King of Prussia Road, Suite 100
Radnor, PA 19087-5152
Telephone (484) 683-2600
Facsimile (610) 687-4477

July 2015

TO OUR CLIENTS AND FRIENDS:

With the lazy, hazy days of July upon us, we thought you might appreciate some light summer reading --

<u>Refreshing</u>

Transfer Tax Basics:

- The **"exclusion amount,"** *i.e.* the amount that each individual can transfer during lifetime without incurring gift tax or to the extent not used during life, at death without estate tax, is $5,430,000 for calendar 2015. This amount derives from $5 million, *adjusted for inflation each year since 2010.* It is used automatically as gifts are made.

- Since 2011, "**portability**" can effectively increase a surviving spouse's exclusion amount by his or her predeceased spouse's unused exclusion amount. Because of the marital deduction gifts to a spouse, either outright or in certain trusts, do not use exclusion amount.

- The "**GST exemption**," *i.e.* the amount an individual may transfer to or in trust for a grandchild or more remote descendant (or an unrelated individual who is more than 37 ½ years younger) without incurring generation-skipping transfer tax at the time of the initial transfer or on a trust distribution, is the same as the exclusion amount. Unlike the exclusion amount, the taxpayer can choose where and when to use his or her GST exemption and portability is *not* available.

- Gifts, estates and generation-skipping transfers are subject to a flat tax **rate of 40%** once the respective exclusion amount or GST exemption has been exhausted.

- The gift tax **annual exclusion**, *i.e.* the amount that each individual can give each year during life to any number of other individuals without using any exclusion amount or incurring gift tax, is $14,000 (or $28,000 for a married couple) in 2015. Gifts in trust are eligible for the annual exclusion to the extent a beneficiary receives a "present interest" in the amount transferred.

Look Up and Contemplate the Alignment of the Stars

The exclusion amount and the GST exemption are higher than ever before. If your estate planning documents include trusts for your spouse for the sole purpose of utilizing the exclusion amount, you may be able to eliminate those trusts. There is no estate tax rationale for a trust for an individual whose marriage is secure and whose desire to benefit a surviving spouse and children far outstrips the desire to benefit more remote descendants. Of course, there remain other well-grounded non-tax reasons to include trusts, such as protection of beneficiaries from losing trust assets due to immaturity, dangerous lifestyles, incapacity, spendthrift tendencies, or creditors (including spousal creditors in divorce). Our recommendation is to take a fresh look at your personal goals and consider whether one or more trusts should continue to be included in the testamentary estate plan.

Turn Off Auto-Pilot

Since the increased exclusion amount and GST exemption, we have encountered a variety of situations in which self-executing formula provisions in documents signed five or more years ago create unintended results. As an example, when the GST exemption and the exclusion amount were much less than they are today, it was not uncommon for a grandparent to create a generation-skipping trust to be funded by formula (*e.g.* the maximum available GST exemption) for the primary benefit of grandchildren and more remote descendants, leaving only the amount in excess of the GST exemption to his or her spouse or children outright and free of trust. If today's $5.43 million GST exemption is a substantial portion of the grandparent's estate, the formula may overfund the grandchildren's share at the expense of the surviving spouse's well-being or the children's inheritance.

It's All About That Basis

Increased income tax rates coupled with reduced estate and generation-skipping transfer tax rates have refocused planning on minimization of income tax. Over the last five or six years, many of our clients transferred assets to irrevocable trusts. The assets in these trusts will avoid federal and state death taxes upon the client's death but will not get an adjusted income tax basis. Sale of any low basis assets by the trust may lead to substantial capital gains tax. If these assets are held in a grantor trust, the grantor could, if permitted by the terms of the trust instrument, exchange cash or higher basis assets for them. The exchange would reduce capital gain for the trust after the grantor's death.

In addition, the appreciated assets taken back by the grantor will receive a step-up in basis if held by the grantor at death.

Lighten Your (Income Tax) Load

Non-grantor, non-charitable trusts are taxed on undistributed income over the $12,300 threshold

at the highest rates and are also subject to the Medicare surtax of 3.8%, so that a combined tax rate of 43.4% is possible. Therefore, income tax planning is now a more important part of trust administration. It is important to consider whether to distribute income in non-grantor trusts that contemplate or allow for the accumulation of income, even if those trusts are exempt from the generation-skipping tax. Distribution of trust income to a beneficiary will avoid the Medicare surtax to the extent the beneficiary's adjusted gross income, after the distribution, is below the threshold ($200,000 for individuals, $250,000 for married filing jointly). Similarly, distribution of ordinary income from a trust to a beneficiary who is in a lower income tax bracket than 39.6% ($413,200 individual/$457,600 married filing jointly) may result in significantly less tax on that income. There may also be opportunities to move the tax impact of capital gains earned in a trust to the beneficiaries by distributions.

Let It Go

Depending on the size of your assets and the estate planning decisions you have made in the past, you may want to see if it is possible to terminate trusts previously established, even irrevocable trusts. For example, you may have created an irrevocable life insurance trust to pay federal estate tax when exemptions were lower. If the trust or the policy has become less desirable, you may be interested in taking steps to retain the policy without the trust structure or letting the policy go altogether.

More on Portability: Can You Use Your DSUE?

Portability of a deceased spouse's unused exclusion amount ("DSUE") is a taxpayer-friendly feature of our transfer tax system that is here to stay. Portability is not automatic, however, and requires the filing of a timely and complete federal estate tax return. The Treasury Department's recently released final regulations declined to provide permanent relief from the timely filing requirement for estates with a value below the exclusion amount (and not otherwise required to file). For estates that miss this timely filing, relief in the form of a private letter ruling may be available. The filing requirement, and other risks associated with loss of portability (such as remarriage and loss of a subsequent spouse) are still unfamiliar territory to many clients. Portability, while a simple concept, requires careful attention to the details.

* * *

We wish you a safe and relaxing summer. If you would like us to review your estate documents and/or advise you regarding your situation in particular, please let us know. We look forward to hearing from you.

Gadsden Schneider & Woodward LLP

Christopher H. Gadsden	cgadsden@gsw-llp.com	484-683-2623
Pam H. Schneider	pschneider@gsw-llp.com	484-683-2615
W. Steven Woodward	wswoodward@gsw-llp.com	484-683-2622
Tracy Blake DeVlieger	td@gsw-llp.com	484-683-2617
Kim V. Heyman	kheyman@gsw-llp.com	484-683-2616
Lisa M. Rhode	lrhode@gsw-llp.com	484-683-2630
Benjamin K. Rodgers	brodgers@gsw-llp.com	484-683-2624
Timothy D. Miles	tmiles@gsw-llp.com	484-683-2632

~~~~~~

As mentioned in our previous mailings, we would like to keep you informed of new developments by email. If you would like to receive such email updates, please "Join Our Mailing List" at our website www.gswlaw.net.
~~~~~~