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ESTATE TAX PLANNING IN THE YEAR OF NO ESTATE TAX  
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Contrary to many of our 2009 predictions, the Federal estate tax did, in fact, expire on December 31, 2009. It is scheduled to reappear in 2011. There are now indications from Congress that the 2009 exemption level of \$3.5 million will be enacted during 2010 with retroactive applicability to January 1, 2010. Given the still fragile state of the economic recovery, the reimposition of some form of Federal estate tax is almost certain.

If you have already executed your estate planning documents, it is time to review them. The results can be drastically different now.

Way back in the year 2002, the Federal and New York State estate tax thresholds were both \$1.0 million. The most basic concern of estate tax planners back then was to prevent the inadvertent loss of this credit. This occurred under simplistic Wills that left everything outright to a surviving spouse who, in turn, left everything to children. The unlimited marital deduction under the Internal Revenue Code provides that there is no estate tax liability on transfers to a surviving spouse. If for example, a couple had an estate of \$1.5 million and the husband died in 2002, his wife received everything free of estate tax. But, because there was no tax liability upon the first death, there was no opportunity to use his credit. It died with him. Later that year, upon the death of the surviving spouse, the children could only use her credit of \$1.0 million – thus exposing \$500,000 to both Federal and New York State estate taxes.

To prevent the loss of the first credit, estate planners worked to create a tax liability for the first estate. This was done by creating a so-called Credit Shelter Trust for each spouse which would receive a portion of the estate thereby preventing the over-utilization of the marital deduction credit.

There were several ways to fund this trust. The most common was the following: “I give my Trustee, hereinafter named, the maximum amount that can pass free of Federal estate tax ...” Well, for a decedent in 2002 with a \$2.0 million estate, the result was for \$1.0 million to go into the Credit Shelter Trust upon the first death and the surviving spouse kept the remaining \$1.0 million. Upon her death, the children received everything free of any estate tax.

Fast forward to the present – Those documents have dramatically different results. Now, the “maximum amount that can pass free of Federal estate tax” is unlimited. Therefore, all of the first decedent’s separate assets will go into the trust. Depending upon how assets are titled, this could leave the surviving spouse with nothing! They could pursue elective share rights, but this is an incomplete and inefficient solution. Moreover, funding the Credit Shelter Trust with more than \$1.0 will trigger an immediate New York State estate tax consequence. This is because New York State still has a \$1.0 million exemption.

When computing the taxable estate, one must count nearly everything. Contrary to popular belief, the fact that an asset passes automatically at death does not mean that it will necessarily escape estate taxes. Life insurance death benefits, IRA’s, 401K’s and jointly owned property are all counted.

One possible solution to the uncertain Federal tax situation that will also prevent the inadvertent trigger of New York State tax is to create Credit Shelter Trusts funded with a disclaimer mechanism. This

would provide that all assets pass to the surviving spouse with the exception of whatever amount he or she chooses to disclaim into the trust. Internal Revenue Code § 2518 allows nine (9) months from the date of death for a disclaimer to be made. This gives us the advantage of making a decision in light of the Federal and New York State tax laws as they exist at that time. Any assets so disclaimed will be held in trust for the lifetime benefit of the surviving spouse. Upon his or her death, the assets pass to the successor beneficiary as if they came from the first decedent. Therefore, we get to utilize his or her estate tax credit.

Those with estates above \$2.0 million and anyone concerned about liability issues may be well advised to consider an additional type of trust known as an asset protection trust.

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