BDF Balasa Dinverno Foltz LLC
Private Wealth Management
Itasca • Chicago

February 24, 2012

Estate and income tax planning takes center stage in 2012 due to the convergence of the expiring Bush tax cuts, estate provisions that will change in 2013, and the new tax increases proposed by the current administration. Various opportunities exist to implement creative strategies to lower overall tax obligations. Mike Foltz, who heads up our Business Owner Service Team, recently attended the University of Miami Heckerling Estate Planning Conference where many such planning techniques were discussed by leading experts.

Income Tax Changes

Absent further legislation, several income tax provisions are set to change after 2012. The capital gains tax rate will increase from 15% to 20%, dividends will be taxed as ordinary income rather than at more favorable capital gains rates, and income tax rates will generally increase for most brackets with the maximum rate going from 35% to 39.6%. In addition, President Obama's 2013 budget set forth new proposals such as higher rates for those making over $200,000, limitations on itemized deductions for upper income taxpayers, and other provisions aimed at increasing the tax bite for upper income earners. Thus, it may make sense in certain cases to recognize capital gains in 2012 rather than deferring them to later years, and when appropriate, it may be preferable to accelerate income into 2012 to enjoy the lower rates.

An area of concern is IRAs and other tax-deferred investments. Since these vehicles will ultimately be taxed to the owner or to the beneficiaries, Roth conversions or outright taxable distributions in 2012 should be considered, when appropriate, especially if the taxpayer will have little or no earned or other ordinary income. An added benefit of doing this is that the payment of any income tax will lower the amount of assets exposed to the estate tax at the owner's death.

Estate and Gift Tax Changes

One should also consider potential estate and gift tax changes. The estate and gift tax exemption is set at $5,120,000 for 2012, but will automatically decrease to $1,000,000 on January 1, 2013, if Congress fails to act before then. The budget proposals described below may change the landscape further. The following are some important tactics to consider implementing in 2012 before any changes take place:

- Consider making large gifts in 2012 before the $5,120,000 exemption expires. Because of low interest rates and asset values, gifting strategies can effectively use the current exemption and remove future appreciation of assets from later estate taxation. The major downside to gifting is that liquid assets earmarked for retirement are given away. However, gifts can take many forms such as a qualified personal residence trust (QPRT) for a non-income producing residence.
- A lifetime credit shelter trust may be used to reduce the taxable estate. Traditionally, this type of trust is created at the first spouse's death, but may be formed during one's lifetime by utilizing some of the available exemption amount. It may make sense to use the $5,120,000 exemption and shelter future asset appreciation from estate tax.

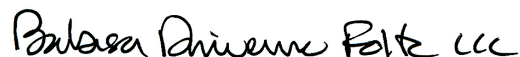
500 Park Boulevard, Suite 1400
Itasca, IL 60143
Phone (630) 875-4900 • Fax: (630) 875-1150
www.bdfllc.com
222 N. LaSalle Street, Suite 1450
Chicago, IL 60601

- Portability, which is the ability for a surviving spouse to utilize the deceased spouse's unused estate tax exemption, necessitates a fresh look at beneficiary planning for those with sizeable IRAs or other tax-deferred plans. If the surviving spouse is named as primary beneficiary, he or she can then elect to use the decedent's unused exemption amount. Portability also helps those living in states with exemption amounts lower than the federal threshold. For example, Illinois recently enacted a $3,500,000 exemption for 2012 and $4,000,000 for 2013. A decedent's credit shelter (family) trust could be funded with the lower Illinois exemption amount and the unused federal exemption could be used by the surviving spouse.
- For those with asset protection concerns, domestic asset protection trusts (DAPT) may be a viable strategy. Many states now permit a person to create an irrevocable trust, be its beneficiary, and shield the assets from creditor claims. Some states (i.e., South Dakota, Nevada, and Alaska) do not tax trust income and make it easy for out-of-state persons to create DAPTs in their states. A person may have to use some of his or her exemption amount to establish such trusts.

President Obama's budget proposes several dramatic changes to long-standing estate planning techniques. Those changes include the elimination of valuation discounts, lowering the exemption amount to $3,500,000, a minimum ten-year term for grantor retained annuity trusts (GRATs), limits on the terms of generation-skipping trusts, and the elimination of "grantor trusts," which are tax-favored for income and estate tax purposes.

BDF recommends our clients consider meeting with their attorney to assess the need for changes to existing estate plans. Many opportunities exist to adopt tax-saving strategies in this low interest rate and asset value environment. ***Please contact us if we can answer any questions for you or if you would like to know more about how BDF's comprehensive wealth management services can be of benefit to you.***

Best regards,



Balasa Dinverno Foltz LLC
MCF/jia

Any estate planning or tax advice provided by BDF is ancillary to its investment advisory and financial planning services. BDF does not provide written opinions regarding tax matters, and no part of BDF services or this document should be relied upon as a written tax opinion. The content of this document is not a substitute for the advice from an attorney in the relevant jurisdiction. Balasa Dinverno Foltz LLC does not practice law nor does it render tax or legal advice. Estate planning requires legal counsel in the relevant state or local jurisdiction. A copy of our current written disclosure statement discussing our advisory services and fees continues to remain available for your review upon request.