RETHINKING WEALTH TRANSFER

Northern Trust experts discuss the 2010 Tax Relief Act and its implications for wealth planning in 2011

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R. Hugh Magill

Good afternoon. Happy New Year, and welcome to today's call focusing on the 2010 Tax Relief Act and its implications for wealth transfer planning in 2010, 2011 and 2012. I'm Hugh Magill, and I serve as Northern Trust's chief fiduciary officer and global director of trust services.

Joining me on today's call are Grace Allison, Northern Trust's tax strategist, Ray Odom, our national director of wealth transfer services, and Stacy Singer, who manages our Estate Settlement Services Group in Chicago.

We will begin by looking back at December. December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act. That's a long title, so we'll generally refer to it as the Tax Relief Act of 2010.

That Act provides extraordinary resolution of the rough landing we would have had January 1, 2011, when the Bush-era tax cuts would have expired. It was bipartisan in nature, although there were some fairly significant conflicts behind that bipartisanship. And it contains several surprises, which are all good news.

The only bad news is that it's a short-term kind of relief. It provides only two years of tax relief, after the end of which things will plummet back to their 2001 levels. This pushes the ultimate resolution of our transfer and income tax circumstances to the representatives seated in Congress in 2012.

The act itself is blessedly short – my copy is only 23 pages long – and it contains many provisions for both individuals and businesses. Today we'll almost exclusively be focusing on the provisions for individuals.

Grace Allison is going to be focusing on income tax momentarily. Ray Odom will then talk about the opportunities for both wealth planning and estate planning. Then Stacy Singer will talk about the provisions for families who lost a loved one during 2010 – in other words, the estate settlement provisions.

Let's turn then briefly and do an overview of what the Act provided in the realm of wealth transfer taxes. It leveled the playing field for wealth transfer. By that I mean that for the gift tax, the estate tax and the generation-skipping transfer tax, which we'll sometimes refer to as the GST tax, all of those now have a $5 million exemption. It will be indexed for inflation in 2012 and it provides a uniform 35% rate for all of those taxes.

As I mentioned, in 2013, if Congress does nothing to extend this two-year window, these exemptions will plummet back down to levels that we are unaccustomed to now. Federal, state and gift tax will plummet to $1 million, and we estimate the GST tax would drop down to about $1.4 million and the rates would rise to 55%.

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The Act then expands the opportunities for lifetime planning in some very significant ways, particularly with gifts in trusts for descendants. Ray Odom will be talking about some of these opportunities momentarily. The act also significantly did not restrict the use of some of the common transfer planning techniques such as grantor retained annuity trusts or gifts that might be accomplished using a family-limited partnership or perhaps a limited liability company.

And lastly and very importantly, a gift for married couples – a surviving spouse may now utilize a pre-deceased spouse's unused exemption. In other words, there is no more penalty for imbalanced estates. That's sometimes called "portability" in the trade, although we're going to try to use as few trade terms as we can in today's overview.

We're now going to turn to Grace.

Grace, you've published two *Tax News* articles since the legislation was signed, providing our clients with a range of planning considerations both in 2010 and ideas for 2011 and 2012. What do clients need to know about the income tax planning environment in the next two years?

Grace Allison

Hugh, the 2010 Tax Relief Act will have a significant effect on individual income tax liability for 2011 and 2012. Big picture: The Act keeps the top income tax rate at 35%, with capital gains and qualified dividends both taxed at a maximum 15% rate. In contrast, without the Act, the Bush tax cuts would have expired at the end of 2010. As a result, beginning in 2011, ordinary income, short-term capital gains and qualified dividends would all have been taxed at a top rate of 39.6%, while long-term capital gains would have been taxed at a maximum 20% rate. Doing the math, this means the tax rate on qualified dividends would have increased by 164%, while the long-term capital gains rate would have increased by a third.

The affect on those with substantial investment income would have been dramatic. Assume, for example, a married couple in the top income tax bracket filing jointly with investment income of $400,000, $100,000 from qualified dividends and $300,000 from long-term capital gains. Had the Bush tax cuts been allowed to expire, their income tax liability on that investment income would have been almost $100,000. In contrast, under the Act, their income tax bill falls to $60,000. You get the idea.

The 2010 Tax Relief Act is good for investors. The relief, however, is short-lived. The 2010 act expires at the end of 2012, and if the 112th Congress fails to enact new legislation, the old pre-Bush tax rates will return – a 39.6% top rate for ordinary income and qualified dividends, 20% top rate for long-term capital gains. Of course, we can't know now what will happen two years from now.

At a minimum, however, those holding concentrations in their investment portfolios will want to consider recognizing gains in the next two years while the maximum long-term capital gains rate is still 15%. Similarly, those still contemplating a Roth IRA conversion should take into account the current 35% tax rate on the conversion income.

To a much lesser degree, the Act also brings some relief for wage earners in the form of a payroll/self-employment tax cut designed to stimulate the economy by putting a little extra money in the pockets of those who pay employment or self-employment tax on their earnings. For those with earned income from wages, the employee portion of the non-Medicare payroll tax is cut for 2011 only from 6.2% to 4.2%. For those with income from self-employment, the Act reduces the self-employment tax bite from 12.4% to 10.4% – again for 2011 only on the non-Medicare portion of self-employment taxes. Doing the math, for those with income of $106,800 or more, this amounts to a savings of about $2,100.

A third benefit of the 2010 Tax Relief Act comes in the form of alternative minimum tax relief. Had Congress not increased the amount exemption, indexing it for inflation for 2010 and 2011, an estimated 25.2 million taxpayers would be subject to minimum tax in those years. Thanks to the Act, 21.3 million of those taxpayers have dodged the bullet – at least temporarily.

That brings us to two other short-lived benefits of the Act. First, those 70½ or older can direct to distribution of up to $100,000 from their traditional IRA to a qualified charity and have the distribution be tax-free. This provision is effective for 2010 and 2011, but there is a way to take advantage of it for both years now if you act quickly. A special provision deems distributions to charity made before the end of this month to have been made on December 31, 2010, if you so elect. In other words, if you act before January 31, you can still take advantage of the $100,000 transfer to charity opportunity for 2010, and then if you wish take advantage of it again for 2011. And yes, any such transfers are taken into account in determining whether you have satisfied your minimum distribution requirements.

Second, the Act extends also for 2010 and 2011 only, an enhanced 50% charitable deduction for qualified conservation contributions, including easements, as well as other types of transfers to a qualified conservation organization. For certain transfers by farmers and ranchers, that 50% limit is increased to 100%.

Now, as you'll remember, the Tax Relief Act of 2010 was enacted on December 17, 2010. You may be wondering how the IRS is coping with legislation that wasn't signed into law until two weeks before the start of tax season. Yes, new withholding tables are out that reflect the new payroll tax cuts. But the news is not as good on the tax return side. If you itemize your deductions on Schedule A, you will need to wait to file your tax return until the IRS finishes reprogramming its computers, likely the end of February.

Magill Grace, thanks very much for that overview of the Act's provision on income tax. As Grace mentioned, our listeners should note that even though the IRS may not have all of its forms prepared, it isn't too early to begin preparation of your materials for the 2010 filing season, and your meeting with your tax advisors.

Now that we've spent some time taking a look at the impact of the legislation on both income and the transfer tax front, I'm going to turn to Ray Odom.

Ray, as I mentioned in my introduction, the Act offers extraordinary opportunities for wealth transfer. How would you advise clients of some ways they can best take advantage of the window that exists in the next two years?

Raymond C. Odom Thanks, Hugh. There are three points I want to make: what Congress did, what Congress didn't do and what our clients should be thinking about.

When I talk about what Congress did, I want to emphasize the title of the section that dealt with estate tax. It was called "Title 3: Temporary Estate Tax Relief." Let me rephrase that to emphasize the point – temporary death tax relief for taxpayers becoming permanently dead by 2013. You can see the anomaly. We're really talking about something that for estate tax purposes is only effective for someone who dies before 2013.

But for purposes of looking at estate tax, and for estate tax planning, let's look at what would happen during those years if there were a death. For instance, the first spouse to die of a married couple has a $5 million applicable exemption amount. That amount, if it has not been used up by prior gifts and it is not used up at death, can be transferred to the surviving spouse, giving that surviving spouse up to $10 million that they may leave to beneficiaries at death or even during life. So that $10 million amount for the surviving spouse is a big difference in the Act and needs to be considered in estate planning documents.

But let's forget about dying and estate planning. Let's talk about living and lifetime wealth fulfillment. It's one of my favorite topics, and on that score, as Hugh mentioned already, the Tax Relief Act of 2010 hits the jackpot. I mean, it's Lotto time, because the exemption amount increases over 400%.

We have never had a gift exemption amount that has been in excess of $1 million. Some might be confused by that statement, because they are saying, "Wait a minute, I remember when the exemption amount went up from $600,000 to $1 million, then to $2 million and then to $3.5 million." But that's the death tax exemption amount. The gift exemption amount was always only $1 million.

And of course, as you've already mentioned, Hugh, the top rate is 35% when you exceed the exemption amount of $5 million.

That gets us to what Congress did not do. One of the things I want to emphasize is this is a time when clients must know their intent. And I'm going to refer to that intent as figuring out what you would do with your assets if there were no taxes involved. The key is to have your intent figured out based on what your wealth transfer fulfillment goals are. And to talk about that, I use three letters: A, B and C.

"A" stands for assets – your real assets, what really matters to you. "B" stands for behaviors – the things you want to see your assets fund; behaviors you either want to change, maintain or encourage. "C" stands for culmination – the culmination of your objectives. So you want to have the funding of your real assets to get the desired behaviors to be a culmination of your legacy goals.

Now after you do that, you're ready for the tools. For the tools, I use three letters: D, E and F. "D" is for discount, "E" is for exemption, "F" is for freeze. As Hugh has already mentioned, those tools were not changed by Congress.

Let's talk about the discount tools. Hugh already alluded to the most important discount tool. Discount tools are those things you do to decrease the market value of assets that could otherwise be transferred. For instance, let's suppose you had $7 million of market value in assets. You decide to transfer that into an entity that restricted marketability and liquidity. That would potentially reduce the market value from $7 million to $5 million. That $5 million could then be transferred into a trust. And that trust could not only benefit children, but because the gift tax exemption amount is also equal to the generation skipping exemption amount, you could actually set up a trust that benefits grandchildren, great grandchildren and, under some states' law, you could even benefit your descendants in perpetuity.

So the reality is, the discount tools help fund trusts that could be much more effective in the current environment.

What "E" stands for is exemption. Of the "E" tools, the one I want to mention in particular is the charitable deduction, which is really in effect an exemption. And that exemption hasn't been changed. So all those charitable tools work – charitable remainder trust, charitable lead trust, private foundations – those still do not cause a transfer tax on the movement of monies to charity.

And remember, the marital deduction can act like an exemption when, as some clients did, you transfer a gift by giving it to your spouse and then the spouse dies in a year like 2010 that does not have estate tax. So you want to keep the marital deduction in mind; it continues to be a good technique.

Let's talk about the freeze tools. That's the initial "F." The No. 1 freeze tool that everyone was talking about in 2010 and 2009 was the GRAT – the grantor retained annuity trust. And remember, that technique counted on the fact that trusts were very short-term and you did not pay gift tax. We thought that Congress might require a gift tax be paid and require that the term of the grant be longer to trap the assets back into the estate. Well Congress did nothing. GRATs are good to go. There's no need to rush to do them. And remember, they are a freeze technique. If you have a $100 million estate and you do a perfect GRAT, you'll still have an estate that's $100 million.

Other freeze techniques that are unaffected by the law were sales to intentionally defective grantor trusts. You remember that many people have been doing these, and the most important thing that happens with those is you start the trust with a gift. That seed gift previously could only be $1 million. Now, that seed gift could be $5 million and not require any gift tax to be paid. Remember that qualified personal residence trusts are still available. And one of the things I wanted to point out is that grantor retained income trusts for unrelated couples are a tremendous technique that hasn't been touched by the law.

Now we're down to what you should consider doing, and really it's kind of specific and direct. No. 1: Do your "ABCs." Meet with your wealth advisors, wealth strategists and managing directors, and get your intentions clear. Get the "how," "when" and "why" of your intentions carefully drafted out.

Then consider large gifts in trusts for younger-generation beneficiaries. Remember, Northern Trust makes an ideal trustee in those situations. And remember to include broad discretionary language. It's also possible to use third parties – trust protectors or power holders that can change the trust terms if there are unforeseeable circumstances or a change in tax law.

Remember that you need to visit your estate planning attorney to adjust to anything that has happened with the current law – provisions to allocate your applicable exemption amount, disclaimers, joint trusts.

Remember most of all Odom's rule No. 1: You must have fun. And in this environment, instead of thinking about death and taxes, you need to start thinking about living legacies you can enjoy now.

Magill

Ray, those are great observations. Thank you. As you illustrated in your comments, the high gift tax exemption really offers some extraordinary opportunities in 2011 and 2012 to transfer substantial wealth when circumstances are appropriate using some of the proven planning techniques that you mentioned, and particularly those that would involve a trust for a descendant.

We'd like now to turn to Stacy Singer, our manager of Estate Settlement Services here in Chicago.

Stacy, a lot of families who lost loved ones in 2010 had a year of great difficulty, not only in grieving but in dealing with the uncertainty of 2010 tax law. Congress, though, has resolved that uncertainty and given them some alternatives as to how they proceed with the estate administration. Can you describe that to us?

Stacy E. Singer Sure, Hugh. Let me give you a little background. The law prior to December 17, 2010 had said under the 2001 tax act, there was no estate tax in 2010 for people who died in 2010. The challenge was that those decedents had instead what's known as carryover cost basis, which means the cost basis of those assets in the hands of the beneficiaries was the same as the cost basis in the hands of the decedent.

That created a lot of challenges for two reasons. First, many individuals didn't have cost basis information. And secondly, many people held on to assets for a very long time specifically to receive the step up in cost basis at death.

Now the 2001 Act did provide, before the December 17, 2010 changes, for two allocations to increase cost basis: $1.3 million to anyone and $3 million to a spouse or a trust for the benefit of a spouse. It provided every return was due April 18, and it gave no guidance on how any of this would work.

Fortunately, when Congress passed the Tax Relief Act of 2010 and President Obama signed it, it provided a lot of clarity on how to deal with deaths in 2010. What it did was retroactively enact an estate tax effective as of January 1, 2010, with a $5 million exemption, a 35% tax rate, a $5 million GST exemption and a full step up in cost basis to the value as of date of death.

However, to avoid challenges to the constitutionality of something enacted retroactively, Congress provided that an executor or a trustee can opt out of that estate tax system and instead elect the carryover basis system that would have applied under the 2001 Act, with the same $1.3 and $3 million allocation amounts available.

What does that mean for executors or trustees who are handling estates or the families who have lost a loved one? For the most part, if an estate has a value under $5 million, it's likely that you will elect into estate tax because there will be no estate tax paid and there will be a full step up in cost basis. This eliminated the vast majority of estates from having any consequences of the estate tax system.

If the estate has a value over $5 million, it's really a numbers game. It's necessary to look at the amount of the potential estate tax as compared to the amount of potential capital gains tax, and also at what impact the two different regimes will have on how the document actually works.

Many documents, as we talked about last year, had formulas that included specific provisions based on things like the amounts that can pass tax-free or the amount of generation-skipping tax exemption. The 2010 Tax Act may change who receives what or under what terms, and it's important to look at those issues and make sure that the decision that's made about which regime applies is appropriate for all of the beneficiaries.

Finally, it is true that if someone opts into the carryover cost basis regime, the assets set aside for a spouse will not be taxed at that spouse's subsequent death. So there may be reasons to opt into the carryover basis regime simply to avoid a tax at the second death, even though none would be owed at the first death either way.

The law also gave an extension of time to disclaim assets, that is, to essentially reject a distribution of assets from an estate and allow them to pass presumably to the next generation. Originally we thought that the deadline was nine months from the date of death, as has been the law in the past. But because of the uncertainly, the 2010 Tax Act provided an additional nine months from the date the law was enacted for a disclaimer. This provides a lot of opportunities for families to consider if a disclaimer makes sense under the new law. I would encourage anyone in that situation to talk both with their Northern Trust professionals and also with their estate planner about the possible advantages.

In terms of how things are being handled now and the timing, the law does extend all tax return due dates for the estate taxes to September 17, 2011, so there is some time to run the numbers, analyze the results and make some good decisions. But there may be circumstances where it's necessary to look to the courts to help with some of these interpretation issues, because there's simply no clear guidance on what was intended or what the fair result is for all the parties.

Northern Trust has previously published a paper on "Dealing with the Previously Unthinkable: Modified Carryover Basis and 2010 Decedents," which is available at northerntrust.com/wealthtransfer. In the next several weeks, we will be offering additional guidance on how executors should make the election between the two tax regimes and what issues to consider in making that election.

Magill

Stacy, thanks very much for a clear explanation of something on which we didn't expect to have a clear resolution.

As you noted, those in the role of executor or trustee for families who've lost someone in 2010 will have many issues to consider, and the publication that you speak of will be very useful. We hope you will avail yourselves of it if you're in need of it.

That does conclude our prepared comments.

I would like to encourage the audience to contact their Northern Trust relationship manager if they'd like any additional information on topics we've discussed today.

And now we're going to turn to all the questions we've received. We received a number of questions before the conference call today and we've been receiving them steadily throughout. For anyone who would like to still submit a question, the e-mail address is wealthtransferquestions@ntrs.com. We will try to get to as many questions as we can.

Grace, I turn to you for the first question. This client writes, "Please address tax advice for same-sex couples who don't have the tax benefits offered to married couples."

Allison

There are a whole host of wealth transfer strategies that can help LGBT couples reach their goals, from grantor retained annuity trusts to qualified or non-qualified residence trusts to grantor retained interest trusts to charitable lead trusts and charitable remainder trusts to life insurance trusts.

All of these strategies help ensure that the transferring partner's unified gift and estate tax exemption is utilized in a tax-efficient manner. My colleagues in Northern Trust's newly announced LGBT Practice work with these strategies every day and will be happy to discuss them with you.

The important issue that you refer to is that unlike married straight couples, LGBT couples – even if they are married – do not, under current federal law, have the benefit of the unlimited marital deduction for gift and estate tax purposes. Remember, however, that for 2011 and 2012 only, that unified gift and estate tax exemption is $5 million. This provides a wonderful window of opportunity to transfer wealth to a partner during life, either outright or in trusts, without paying transfer tax. And by using some of the strategies I mentioned at the outset, it is possible to stretch that $5 million to the fullest. All of those strategies, by the way, will work for unmarried straight couples, as well.

Magill Thanks, Grace. Stacy, I am going to turn to you for the next question. We've received several of these that involve the interplay of both federal and state estate taxes. One of the things the Act did not do, unfortunately, was to restore something called the state death tax credit. In other words, the provision under federal law that allowed an estate to receive a credit for the estate taxes that would have applied in many of the states. And because of that, many of the states have gone their own direction, enacting their own independent estate or inheritance tax with different rates and different exemptions. I've sometimes said that it's something of a minefield out there when it comes to state death taxes.

Could I ask for your thoughts on the following question? Can you comment on how the federal legislation affects state estate taxes?

Singer Interestingly, in the past, going back several years, we had what was oftentimes called a pickup tax – the idea being the federal government assessed estate tax at a set rate, but essentially allowed a portion of that tax to be paid to a state without an increase in the total tax burden.

Over the last several years since the 2001 Tax Act was passed, that amount has gone down and is now a deduction for state estate taxes. When that deduction became law, many states went their own ways and provided for state estate taxes that hinged on some prior version of the federal law. Those state laws still remain in effect. And they vary state by state, so it's really impossible to give a good overview.

The key is that now that we have a deduction again, and it is clear that it is the law, I anticipate quite a few states are going to go back and look carefully at their legislation and the opportunities that may exist to impose a tax again. And I anticipate we'll see a lot of activity in this area that's going to create some challenges for executors and also for our clients when they are looking at their own domicile and what impact that has on their personal estate planning while they're living.

Magill Stacy, that's very helpful. It does imply to me that all clients need to think about where they're domiciled because where you die can make a difference. Particularly for those clients who own real estate in different states, it's important to discuss with an advisor ways in which real estate ownership can be structured to perhaps take advantages of differences in state estate tax laws. I appreciate your insights on that.

Ray, I am going to ask you to give some advice to the following client who wrote, "I've already given all the money I can give during my lifetime, except for what I can give annually. I think the cap was less than $2 million. Does this mean I can give more if I hurry up and do it before December 31, 2012?"

Odom Well Hugh, at the risk of not answering the question, let me answer it succinctly: Yes! And hurry up!

I think the client is referring to the fact that prior to 2011, you had a $1 million per person exemption if you are a U.S. citizen. And for a married couple, that meant you had a $2 million gift applicable exemption. So the point is you do need to do this before December 31, 2012.

One of the things I should also suggest to clients: There are a lot of people who get nervous about making large transfers of wealth directly to younger-generation beneficiaries. I would point out that a trust provides asset protection for recipients of large gifts. And that can be especially important when you take into account that a transfer to an individual, while that individual may not have any creditors, there's a 50% chance they might go through a divorce if they get married. And that divorce alone could dissipate assets that were intended to benefit the beneficiary.

I would also point out that a gift in trust allows flexibility and, as I mentioned before, the kind of post-mortem estate planning that might be beneficial to a wealth transfer.

Magill Ray, thanks very much. Grace, I turn to you for the next question: "When setting up a private foundation, I understand the tax deduction is limited to a percentage of your income. Does income, for this purpose, include tax-exempt income?"

Allison Private foundations, like donor advised funds, are a great way to pre-fund charitable giving. For transfers to a private foundation, the income tax charitable deduction is limited to 30% of adjusted gross income for transfers of cash and to 20% of adjusted gross income for long-term capital gain property such as long-term securities. Adjusted gross income does not include tax-exempt income.

The best way to estimate your charitable deduction in the year of contribution is to ask your accountant to run a projection. Keep in mind also that contributions made in any year that are in excess of the amount currently deductible can be carried forward and deducted to the extent allowable in any of the five following years.

If you are looking for an as-large-as-possible charitable deduction in the current year, you may want to consider establishing a donor-advised fund. The deduction limits for donor-advised funds are more generous than for private foundations: 50% limitation for gifts of cash, 30% limitation for appreciated long-term securities. And by the way, Northern Trust has its own donor advised fund, The Northern Charitable Giving Program.

Magill Grace, thanks for the clarity in a area that's often a source of confusion about how to calculate the charitable deduction, given both the receiving entity and the type of asset or cash that's being contributed.

Stacey, I'm wondering if you could offer insights to the following client who asks: "Please comment on step-up value for appreciated value that is given as a gift for 2011 and 2012."

Singer This is a great question and a source of a lot of confusion. It has always been true that when a gift has been given, the recipient keeps the same cost basis that the donor had. There's never been a step up or change in basis between the donor and recipient. And that continues to be the law in 2011 and 2012. The recipient keeps the cost basis that the asset had in the hands of the donor, and would pay any capital gain tax if the asset is subsequently sold.

Magill Stacy, thanks for clarifying that. And of course, we'd reiterate that in this favored income tax environment, a carryover cost basis system isn't such a bad thing, at least for the next two years in 2011 and 2012.

Ray, I turn to you for the next question. This client asks, "Am I correct that the wealth transfer during one's lifetime is now $5 million beginning in 2011? Can I transfer homes to my children? They are already in a trust in my own name. Can I give gifts of more than $13,000 annually to my children or anyone else without tax?"

Odom

I think the client brings up a good point. And that is that there is still the annual exclusion gift that is at $13,000 for this year. And we should note: that is something you should consider doing. I've always told clients that you want to try to do multiple gifts, and there is actually a way to do that in trusts that also makes a lot of sense.

The client actually mentions transfer of homes. There are two things that make a transfer or real estate really beneficial in the current environment. First, the real estate market is depressed and market values are down. So if I am transferring something that's lower in value, that's beneficial. No. 2, it's easy to get a discount on real estate, either by fractionalization or other methods. So that is a good thing to do.

But I caution this particular caller because he mentions the homes are in a trust. That means it's the trustee that owns it and the trustee that can do the transfer. And if it's in a trust and the trust doesn't have a provision allowing the distribution to children, technically they can't make a transfer. So this client might want to transfer it back to his own name and then make the gift appropriately.

Remember that when you make a gift, you need to eliminate your ownership and use of the property. Many clients forget that when you use the word "home," and you are still living and using that home, and you transfer it out and you keep living in it and using it, it's going to bring the appreciation right back into your estate. Of course, if you have use of that home, you want to make sure you set up fair market rental with the new owners.

I should also mention that, yes, the $5 million is in effect for 2011.

Magill

Ray, thanks a lot for those insights. One of the things we've found in talking with clients about using qualified personal residence trusts, or QPRTs, to transfer homes or possibly vacation homes to children is that at the end of the term, the prior owners become tenants and they have to pay rent based on fair market value. Sometimes, it's uncomfortable for parents to be paying rent to their children. That requires coming back to look at intent and impact of that kind of opportunity. And yet, while we have this $5 million window, it's a very good time to think about using that kind of transfer structure.

Stacy, I turn to you for another important question. We're going to turn toward portability. "Does the GST exemption port in the same manner as the decedent's federal estate tax exemption? I've read contrary opinions on this."

Singer

Hugh, that's a really great question. As a reminder to everyone, the idea of portability is simply that if an individual dies during 2011 or 2012 having not utilized their full $5 million, the amount that is left is transferred to the surviving spouse, who can use it either to make lifetime gifts or at their own death to pass property under their estate plan.

The GST exemption does not transfer in that way. So GST is one place, as you've heard already, where it's really essential to think about making lifetime gifts or ensuring that you use it all at your death, because any that is unused is wasted. The opportunity to pass potentially significant amounts of wealth to grandchildren is lost, as well.

Magill

Stacy, thank you. We're going to stay on the same topic for the last question we're going to answer today.

This one also focuses on portability: "Most married couples want the survivor to take all of their property outright. As planners, we have recommended a credit shelter trust at the first death to take advantage of the lifetime exemption of the first to die. But with portability, should we recommend that a couple with, say, $7 million just put all of their assets in joint ownership? It is far simpler than using a credit shelter trust and directly addresses the typical couple's desires to leave all assets to the survivor."

I'll offer some comments on this – first of all having to do with joint ownership. Here, we'll assume the caller meant joint ownership with right of survivorship. It's a very simple form of ownership, and it can be applied to bank accounts, securities and a host of assets. It means that upon the death of the first to die, the entire asset will vest automatically in the survivor.

It does, though, pose some risks, given the potential of disability. Generally, I think planners believe – and I believe, as well – that an irrevocable trust is a better means to manage an asset and ensure continuity of management control in the event that one of the owners becomes disabled.

There may be creditor protection for a primary residence that's held in certain states if they use a certain tenancy called "tenants by the entirety."

But coming back to the credit shelter trust, sometimes called a bypass or a B trust, they do protect the assets, first against potential claims of creditors and secondarily against the risk that there could be a potential transfer of those assets to a second surviving spouse. There is also a lot of flexibility that can be incorporated in trust design, so the trust can provide attributes that are a lot like ownership –distribution of income, distribution of principal under a certain standard, withdrawal rights, powers of appointment that can be exercised during life and at death.

So in general, I think the credit shelter or the bypass trusts will still play a significant role in estate planning design, even during this period in which the exemptions have increased so significantly.

Unfortunately, we are out of time to answer any more questions. As we wrap up the call, we're very grateful you chose to spend time with us today, and for the confidence you place in Northern Trust.

As we all look ahead into the new year, I also want to draw your attention to a recent paper from Northern Trust's Chief Investment Strategist Jim McDonald entitled, "2011 Outlook: Seeking Escape Velocity." In this paper, Jim presents Northern Trust's investment outlook and strategy for 2011 on several topics including economic growth, inflation, fiscal repair, central bank policies and political leadership – and offers insight on both municipal bonds and our strategy on equities. You can find this paper at northerntrust.com/marketinsights under "Market Commentary."

This concludes our call today. We're grateful for your participation and we wish you a good afternoon.

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