Thoughts About Planning in Uncertain Times

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Thinking back to the 2001 legislative changes (the "Mendacity Tax Act"), we entered a flat tax estate and generation-skipping transfer tax environment in January 2006 when the applicable exclusion amount became $2.0 million. When that occurred several hoary old estate planning notions became bankrupt. For example, as shown in note 11 at page 16, estate freezing became yesterday's game, although several closely related planning opportunities remain (such as payment of tax early, using dollars that are fixed in value, to shelter the growth in other assets, as illustrated in the half-hot example at page 14).

Today the gift tax basic exclusion amount is $5 million (indexed after 2011 for inflation), portability is a reality (for just two years), the §2011 state death tax credit is gone (but by inaction it may come back in 2013 and some proposals suggest that Congress purposefully might restore it), the §2058 deduction for state death tax enacted in its place needs to be addressed in formula marital deduction provisions (but it goes away in 2013 unless Congress acts to preserve it), and the §2057 Qualified Family Owned Business Interest deduction is gone but it too comes back in 2013 unless or until Congress acts. I doubt that carryover basis will become a reality even if we get repeal in the future but if we do the good news about it is that §1040 limits pecuniary funding gain realization to postmortem appreciation, and debt in excess of basis is disregarded, so marital deduction funding need not adapt.

After 2012, if pre-2002 law is back in effect, the maximum rate will return to 55%, the 5% surtax will be restored for estates of between $10,000,000 and $17,184,000, and the $1.0 million applicable exclusion amount returns, with unified estate and gift tax unified credits. Meanwhile, many planners need to address the balkanization in state death tax law, which may become a critical card issue for some clients. Indeed, the patchwork aspect of planning for this imponderable makes it nearly impossible to plan for, other than by being flexible — to adapt to whatever the state death tax environment is when a client dies. And therein is the first lesson of this discussion. Flexibility is critical to adapt to the situation whenever and wherever a client dies.

Clawback Is a Nonstarter

Before delving into more specific materials, there is enough confusion about the "clawback" notion, and the $5 million basic exclusion amount, that perhaps a tutorial about §§2001 and 2010 might help to understand why clawback is not an issue and need not be considered during this period of uncertainty. The issue is: what if a gift tax free transfer is made in 2011 or 2012 when

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the exclusion amount is $5 million, but at death the exclusion amount has slipped back to $1 million? The following illustrations reveal that this is not a real concern. But even if it was real, it should not discourage gifting during the current period of uncertainty. Because the wealth involved would be taxable at death anyway, if nothing is done with it during life. So, if gifting makes sense currently, and if it can be done tax free now, then the threat that a tax may be incurred at death that is avoidable now is hardly a reason not to proceed. All it suggests is planning that accounts for deferred payment of estate tax on the phantom asset represented by clawback. And that tax apportionment issue is not new or difficult to address.

To illustrate why this is not a serious issue, it is essential first to know that there is no $5 million *exemption*. For ease of discussion many people speak of an amount "that is not taxable," but there is no amount that is not taxable, and there is no estate tax exemption in the Code. The difference between the law and this street-lingo understanding is the source of much of the confusion that exists.

Instead of an exemption, the unified credit (found in §2010) is applied after a taxpayer calculates the tax on every dollar in an estate — nothing is exempted from tax — and then allows the taxpayer to pay the amount of that tax first with the unified credit (and the rest with cash). There *is* a tax on the first $5 million of includible property, but the unified credit is equal to the tax on $5 million. So, you apply the credit and only pay the tax owed to the extent the tax bill exceeds the amount of the credit.

A second essential concept is that using the credit during life does not alter the availability of the credit at death. At first blush this notion is so counter-intuitive that many casual observers assume it cannot be right. The Code is not very easy to comprehend, but it can be illustrated by the following comparison. (Note that all calculations in this discussion assume a maximum tax rate of 35%, which kicks in at $500,000.)

No Gift		Gift
$6,000,000	Taxpayer's Net Worth	$6,000,000
0	Gift	1,000,000
0	Gift Tax Payable	330,800
0	Unified Credit Used	(330,800)
0	Gift Tax Paid	0
6,000,000	Taxable Estate	5,000,000
0	Adjusted Taxable Gifts	1,000,000
6,000,000	Total	6,000,000
2,080,800	Tax on Total	2,080,800
(0)	Credit for Gift Tax Paid	(0)
(1,730,800)	Unified Credit	(1,730,800)
350,000	Tax at Death	350,000

Illustrating a $1 million inter vivos gift in the right column, the tax inter vivos under the current rate table is $330,800 (not $350,000, because there is still a small amount of progressivity in the rate tables, on amounts less than $500,000). None of that $330,800 must be paid (indeed, you cannot pay gift tax until you exhaust your unified credit), because the taxpayer has a unified credit of $1,730,800 (that is the tax on $5 million). So a $330,800 portion of the credit is applied, and no gift tax is paid. The challenge for many students is understanding why the unified credit available in the estate tax calculation is not reduced by that $330,800 amount — notice in the right column that the full $1,730,800 is available in the penultimate line. That is crucial to understanding the law.

In the calculation at death, notice that the tax is based on a total of $6 million — because the inter vivos gift is added to the calculation in the "adjusted taxable gifts" line — and the tax on the total is the same in both columns. That may not be the case in every inter vivos gift situation — it was true here only because the comparison assumes that none of the property changed in value between the gift and death (so as to permit an apples-to-apples comparison). The net effect of adding the adjusted taxable gift to the estate tax calculation is that the taxpayer pays the same amount of tax whether some property was transferred inter vivos or it all passed at death.

Because the $1 million gift is included in the calculation, and because no gift tax actually was paid during life — because the unified credit was applied instead — the credit for gift tax paid in the antepenultimate line of the calculation is zero in both cases. So the result is as if nothing was given during life. By including the $1 million transferred, the calculation essentially ignores the lifetime transfer, and the lifetime use of the credit. Which is why the full unified credit is available at death.

Here is the same example, in which some tax was paid out of pocket inter vivos. This example is not very realistic, but it illustrates the point:

No Gift		Gift
$6,000,000	Taxpayer's Net Worth	$6,000,000
0	Gift	6,000,000
0	Gift Tax Payable	2,080,800
0	Unified Credit Used	(1,730,800)
0	Gift Tax Paid	350,000
6,000,000	Taxable Estate	0
0	Adjusted Taxable Gifts	6,000,000
6,000,000	Total	6,000,000
2,080,800	Tax on Total	2,080,800
(0)	Credit for Gift Tax Paid	(350,000)
(1,730,800)	Unified Credit	(1,730,800)
350,000	Tax at Death	0

Here the tax on the lifetime transfer consumed the entire unified credit and $350,000 of gift tax was paid in excess of that amount. That gift tax paid is a credit at death because the full gift is includible in the estate tax calculation and the tax on the full amount should not be paid a second time. So a credit is given for any tax already paid. And again it is clear that the same $6 million in aggregate taxable transfers incurs the same tax. Notice, too, that the unified credit was fully used inter vivos, but it is fully available in the estate tax calculation at death, again because the full $6 million inter vivos gift is included in the estate tax calculation.

Again, it does not matter when the $6 million was transferred — inter vivos or at death, or a little bit of each. Note also that nothing was exempt from tax. Instead, the tax on the first $5 million was paid using the unified credit. And, because of the way the calculation works, the full unified credit was "again" available at death. The net result is that the taxpayer incurred the same tax in each situation illustrated.

To begin the real clawback conversation, the next illustration below shows what has happened consistently since 1936 — the estate tax exclusion only increased, for the past 75 years. And then, because it could happen, an illustration follows in which the exclusion amount decreases.

First, assume that the exclusion at the time of an inter vivos transfer was $1 million and at death it is $5 million.

No Gift		Gift
$6,000,000	Taxpayer's Net Worth	$6,000,000
0	Gift	2,000,000
0	Gift Tax Payable	680,800
0	Unified Credit Used	(330,800)
0	Gift Tax Paid	350,000
6,000,000	Taxable Estate	4,000,000
0	Adjusted Taxable Gifts	2,000,000
6,000,000	Total	6,000,000
2,080,800	Tax on Total	2,080,800
(0)	Credit for Gift Tax Paid	(350,000)
(1,730,800)	Unified Credit	(1,730,800)
350,000	Tax at Death	0

It is proper that no added tax is paid at death in the right column — because gift tax already was paid on the $1 million that exceeded the exclusion amount at the time of the transfer.[1] Overall the taxpayer incurred the same tax, but in this case some of it was accelerated into a lifetime excise.

Now for the challenging illustration. Assume that the exclusion amount at the time of a gift was $5 million but at death it is only $1 million.

No Gift		Gift
$6,000,000	Taxpayer's Net Worth	$6,000,000
0	Gift	2,000,000
0	Gift Tax Payable	680,800
(0)	Unified Credit Used	(680,800)
0	Gift Tax Paid	0
6,000,000	Taxable Estate	4,000,000
0	Adjusted Taxable Gifts	2,000,000
6,000,000	Total	6,000,000
2,080,800	Tax on Total	2,080,800
(0)	Credit for Gift Tax Paid	(350,000)
(330,800)	Unified Credit	(330,800)
1,750,000	Tax at Death	1,400,000

Notice that the tax in the right column is $350,000 smaller than if nothing had been transferred inter vivos. And that there is a credit for gift tax paid even though the taxpayer did not pay any gift tax inter vivos. Here's why — and this is the linchpin to understanding why clawback does not apply even if the unified credit declines.

1. There is an argument that no credit should be allowed at death for the $350,000 of gift tax actually paid, because the calculation at death is performed as if the gift was made in the year of death and, in this example, in that year the $2 million transfer would have generated no gift tax payable — because the unified credit in the year of death would shelter a $5 million transfer. That would mean that the taxpayer would incur tax at death on the $1 million that exceeds the $5 million exclusion amount, apply the unified credit but no credit for gift tax paid, and thus would again incur tax on the same $1 million that exceeds the exclusion amount at the time of the transfer. In essence the taxpayer would incur tax on $1 million during life and another $1 million at death, as if the total wealth transferred was $7 million, not $6 million. That is not proper, but the Code could be read to produce such an inequitable result. Fortunately, not many taxpayers would consider making an inter vivos taxable gift of an amount that exceeds the applicable exclusion amount if the same wealth might pass free of tax at death.

The Code provisions that generate these rules are §§2001(b)(2) and (g). The former gives the credit for gift tax paid by saying that the credit is

> the aggregate amount of tax which would have been payable under chapter 12 . . . if the modifications described in subsection (g) had been applicable at the time of such gifts.

And then §2001(g) says

> the rates of tax . . . in effect at the decedent's death shall, in lieu of the rates of tax in effect at the time of such gifts, be used both to compute — (1) the tax imposed by chapter 12 with respect to such gifts, and (2) the credit allowed against such tax under section 2505, including in computing — (A) the applicable credit amount under section 2505(a)(1), and (B) the sum of the amounts allowed as a credit for all preceding periods under section 2505(a)(2).

The reason this differs from what might seem more straightforward is because it anticipates the change in rates that also will occur after 2012 (if Congress does not further amend that law). And it means that the credit for gift tax paid is calculated as if the $2 million gift in the example was made when the exclusion amount was only $1 million — because that is the law at the date of death. In which case $680,800 of gift tax would have been calculated on a $2 million gift, and a unified credit of $330,800 would have been applied against that tax bill (that being the tax on $1 million, which would be the exclusion amount in the year of death), *and $350,000 of gift tax would have been payable*. That "would have been payable" amount is the credit at death, *not* the amount that *actually* was paid.

This means that an inter vivos transfer that was tax free (because the unified credit was large enough to avoid the need to pay tax) does not become taxable in the future if the exclusion amount is reduced. And the same result applies under the gift tax rules in §2505 because similar language was added there in 2010 as well.

This is pretty complex, and the significance of these rules is lost if the unified credit concept is confused by thinking of an exemption — as if the first $5 million in today's context was not taxable. The reality is that everything is taxable, but the tax is not paid until the credit is exhausted. That may appear to be the same as an exemption — for street lingo purposes the "exemption" terminology is easier for casual observers to understand — but the Code calculation is very different. And it means that clawback is not a real issue. It also confirms the wisdom of using the exclusion amount while it is available — especially if the chance of a reduction before death seems real. And note that it could also inform use of a portable exclusion amount by a decedent's surviving spouse who remarries and might survive that subsequent spouse, all to short-circuit the sunset and remarriage issues noted at page 9 in items (13) and (14).

Planning for Uncertainty

Planning for some of the provisions in this political theatre is a fool's errand, but there are some basic planning "truths" that can be illustrated by the following discussion, which raises issues in the marital deduction planning and drafting arena in which they are most common:

1. Formula marital bequests send an unpredictable amount to the nonmarital trust.

- Notwithstanding anguished commentary in the last decade as the applicable exclusion amount steadily increased, personally I don't think that it is wise to reconsider your marital vs. nonmarital bequest division, nor do I recommend that the nonmarital be limited in size by some form of cap.

- I also believe that plans leaving all to the surviving spouse (S) and depending on disclaimer of an appropriate and acceptable amount will invite failure — there are just too many ways for disclaimers to go wrong.[2] Note also that plans that rely on partial QTIP elections to engineer the tax result may put the personal representative at risk.[3] On balance my sense is that partial QTIP is a more reliable avenue than disclaimer planning.
- If the family is not friendly, and if there is a desire to shelter as much wealth as possible in a nonmarital trust that favors a broader class of nonspouse beneficiaries, then plans that leave less to S in noncommunity property jurisdictions will invite controversy. The best solution to the potential for litigation postmortem appears to be a marital property agreement that resolves issues that might generate disputes at death. To be binding, however, that agreement probably requires separate representation and full disclosure. All of which makes it an unlikely planning option.
- In most cases my strongest recommendation is to employ traditional marital planning and minimize the consequences of shifting a larger amount (or, after 2012, potentially a much smaller amount) to the nonmarital trust by making the marital and nonmarital trusts as nearly identical as possible. That is, my *default* recommendation (all other things being equal) would be (to the extent the client is willing and the spouse is able) to begin with a template or recommended plan that would provide

  (1) A delayed power of withdrawal in the QTIP trust and a nongeneral inter vivos power to appoint the nonmarital trust,

  (2) Make S trustee of each trust,

  (3) Mandate annual distribution of all income from both trusts, and

  (4) Provide for no other beneficiaries of either trust during S's overlife.

  The rationale for various of these recommendations involves an aggregation of various issues. For example:

  (1) The withdrawal right in the QTIP trust permits S to incur the lowest taxes possible by making inter vivos gifts (and, if relevant, grab assets to take maximum advantage of any basis adjustment available in S's estate at the second death).

  (2) Each alternative serves to minimize the potential for conflict, avoid the use of disclaimers as an affirmative planning device, and similarly avoid the potential for partial QTIP elections to generate gift tax issues.

  (3) Mandatory income and no other beneficiaries serves a §2013 credit planning objective, which also makes adding a five or five withdrawal power for S in the nonmarital trust wise planning.

  (4) It also may avoid the need to comply with the separate share regulations.

  If the income generated by such a plan runs the risk of inflating S's gross estate at death it may be possible to configure the investment portfolio in the nonmarital trust to favor growth over income and eschew principal and income act adjustments that favor the income beneficiary.

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2. See, e.g., Estate of Engleman v. Commissioner, 121 T.C. 54 (2003) (S's exercise of power to appoint marital trust during two month overlife precluded otherwise qualified disclaimer by S's personal representative intended to fund nonmarital trust).

3. Some observers also worry that S may make a gift if acting as executor in making a partial QTIP election causes nonelected property to flip into a nonmarital trust as to which S's enjoyment is different.

2. Deferral of all tax using the marital deduction probably is wise if S is likely to die when the estate tax is in effect. However, if S is likely to die within the §2013 previously taxed property credit window, then that opportunity should be factored into the marital plan, as discussed at page 15. To be so nimble probably requires a plan that permits partial QTIP elections, including if S dies shortly after the decedent (D). The only likely change dictated in many estate plans now outstanding is mandatory income and exclusive benefit to S in a nonmarital trust. This is what many clients want anyway, and it will reduce conflict in all events. If the nonmarital and marital trusts can be made more uniform in their terms it won't matter where the wealth settles — marital or nonmarital, so why would S care?

3. Gifts to a dying spouse are not needed to "fill up" that spouse's estate *if* portability becomes a permanent fixture. If not, however, or if you intend to encourage your clients *not* to rely on portability, then use of both spouses' applicable exclusion amounts may be important, potentially requiring equalization inter vivos. The same planning may be viable for both purposes, using an inter vivos QTIP that denies the spouse control. But not many clients actually will embrace that planning. Which makes most of the following factors for not relying on portability a bit unrealistic, because portability is the only viable way that D's unused exclusion amount will be preserved:

(1) The DSUEA is not indexed for inflation, whereas amounts left in a nonmarital trust can grow during S's overlife and the full appreciated amount will avoid estate tax when S dies. Thus, with a 100% marital deduction and portability the appreciation will be subject to estate tax when S dies, whereas it could avoid tax if it was sheltered from inclusion in S's gross estate because it was in a nonmarital trust. Counterbalancing this factor is the prospect for a reduction in value, and the fact that inclusion in S's gross estate will yield a new basis at S's death, which eliminates any appreciation for capital gain income tax purposes. That would generate a tax saving, but likely at a lower rate (capital gain tax rates being lower than estate tax rates) and only if or when that appreciation was recognized for income tax purposes. It also may be avoidable if D successfully engages in planning that causes inclusion of nonmarital trust appreciated assets in S's estate at death (to the extent doing so will not incur estate tax because S's estate is below S's applicable exclusion amount). Drafting to accomplish that objective is not easy, however, especially if denying control to S is critical to D.

(2) Taxing D's estate on top of S's estate may increase the aggregate tax liability by as much as $19,200, which is the effect of losing the "bracket run" on the first $500,000 includible in D's estate. That is, if D's wealth is taxed in S's estate at 35%, that $500,000 could generate as much as $175,000 of tax, whereas that first $500,000 taxed in D's estate and then sheltered from tax in S's estate would generate tax in D's estate of only $155,800. This increase in tax attributable to portability is the result of "estate stacking" — taxing D's estate on top of S's estate — which can generate tax at S's death in a higher marginal bracket. It would be more economical to tax the first $500,000 in D's estate (with a nonmarital trust or by providing for beneficiaries other than S) and use portability only with respect to the balance of D's estate.

(3) It may be wise in any generation-skipping situation to allocate D's GST exemption to a nonmarital trust, because the GST exemption is not transportable to S. Otherwise a reverse-QTIP election must be made to avoid loss of D's GST exemption. And use on a QTIP trust may not be as efficient as allocation to a nonmarital trust, because income must be distributed currently in the QTIP marital

deduction trust. This means that the GST exemption cannot be leveraged with income earned and accumulated in a nonmarital trust during S's overlife. Also of concern is that D may not favor a QTIP marital deduction trust as to which a reverse QTIP election could be made, or that trust may be too small to fully absorb all of D's GST exemption.

(4) Portability of the DSUEA is a federal tax concept that may not be matched with a similar concept for state wealth transfer tax purposes. This means that any state level benefits of credit shelter planning could be lost. On the other hand, sheltering only the state tax exclusion amount and electing portability for the rest of D's estate may be appealing to clients who wish to defer all state death tax until S's death.

(5) D may wish to make the nonmarital trust available to beneficiaries other than S during S's overlife. This sharing cannot be assured if D elects portability and qualifies property for the marital deduction in reliance on S making that wealth available to those beneficiaries. On the other hand, to the extent S does make that wealth available, the annual and ed/med exclusions make lifetime transfers by S more efficient.

(6) If D does not want S to enjoy or control 100% of D's wealth (for example, because the ultimate objects of their bounty differ), then D must employ a QTIP marital deduction trust that limits S's control, rather than the more flexible and palatable use of a nonmarital trust.

(7) Creditor protection for S may be more effective if D creates a nonmarital trust with spendthrift protection, to shelter the largest amount that can pass tax free at D's death.

(8) Election of portability requires the filing of an estate tax return for D's estate, whereas a smaller than $5 million estate would not need to file at all otherwise. Moreover, that return remains open to audit until after S's death for purposes of challenging the amount of the DSUEA available to S. This *might* mean that valuation or other sensitive issues in D's estate remain subject to government scrutiny for potentially much longer.

(9) Portability requires an election by D's executor that could affect the beneficial interests of various beneficiaries under D's overall plan (depending on how formula provisions are structured and the terms of various trusts that would hold property that is subject to the election). That displacement of benefits could subject the executor to liability to disaffected beneficiaries. Indeed, some planners worry that it might generate gift tax concerns if S is the executor who affected S's entitlement. At a minimum the document should indemnify the personal representative from liability to disaffected beneficiaries.

(10) The portability election could impact D's estate differently, based on the nature of D's includible assets. For example, if a large portion of the estate is retirement benefits the beneficiary designation and the flexibility in naming beneficiaries could play a major role in deciding whether to shelter the benefits in a nonmarital trust or to name S as beneficiary directly and rely on portability, and a rollover election by S to minimize income taxation.

(11) Portability planning may affect whether either D or S's estate will meet various requirements under provisions such as §§303, 2032, 2032A, and 6166.

(12) Portability is a §2010 unified credit concept that applies only if D and S are subject to estate tax under §2001. Portability is a nonstarter if either D or S is a nonresident noncitizen of the United States and their estate is taxable under §2101 instead of §2001, because §2102(b)(1) was not amended to provide a DSUEA.

(13) Portability was adopted in 2010 for just two years. Traditional planning will be required if portability is not extended to transfers after 2012.

(14) Portability may be "lost" if S remarries after D's death and survives that new spouse, because portability applies only for the unused exclusion amount of a decedent's last post-2010 predeceased spouse. Note, however, that it is not known whether S could use D's carryover exclusion amount inter vivos (either before or after remarriage) before S's new spouse dies, and not suffer any form of "recapture" if the new spouse ultimately predeceases S. Nor is it known what happens if S dies before the new spouse and has a smaller estate than the AEA of S's own and D's portable exclusion amount. Does all excess AEA carry over to S's surviving spouse or is S's BEA used first, leaving D's DSUEA, which is not portable again?

Notwithstanding all of these reasons, the traditional marital and nonmarital trust plan may be difficult to embrace if S's estate is not likely to exceed double the basic exclusion amount (and therefore likely will not be subject to tax when S dies), particularly if D and S trust each other (or they do not have different objects of their bounty). It seems predictable that reasons offered by planners to hew to the tried-and-true nonmarital trust approach will fall on deaf ears of many married couple clients.

4. If your old formula marital provision appropriately referred to the state death tax credit, then you should now refer to the §2058 state death tax deduction. I would not delete references to the state death tax credit or the §2058 deduction because Congress *might* reconsider what it has done to the states and *potentially* could retain §2011 after 2012 (which I doubt will happen),.

5. The need for reverse QTIPs continues, especially because the GST exemption and the applicable exclusion amount are not unified after 2012 or under portability. Indeed, part of the applicable exclusion amount may have been used inter vivos on gifts that do not also consume the GST exemption. Which increases the possibility that more of the inflation-indexed GST exemption will be available at death than the amount sheltered in a nonmarital trust. Add the notion of nonprobate property not passing to the surviving spouse or not qualifying for the marital deduction, and nondeductible charges that reduce the typical nonmarital share, and the continued need for reverse QTIP elections seems pretty realistic.

The net effect of these factors seems to be the desirability of postmortem planning that allows engineering of the marital deduction and nonmarital bequests, GST exemption allocation, state death tax minimization, and income minimization through effective use of document provisions that empower and indemnify fiduciaries, and that permit easy qualification for the marital deduction at both the state and federal levels.

Size of the Marital Bequest

First, a disclaimer: we all know that most clients will have nothing of what follows — payment of wealth transfer tax sooner than absolutely necessary — and in many cases this reluctance on their part makes very good sense. Many clients of modest wealth are scared about exhausting their wealth (particularly on health care costs) before S dies.

In other cases the rationale given is that there are liquidity problems that the client would prefer to defer — a notion that is difficult to address objectively but often appears to be foolish, because the client is in a better position to find liquidity during life than relying on successors to find it after S dies. It also leads to investment behavior that encourages married clients to favor survivor life insurance coverage when many more couples (particularly among the baby boomer or younger generations) need first to die insurance instead — because neither spouse alone could support the family's life style on one income, after the death (or, worse, disability) of one of the spouses. In a good number of cases deferral also is informed or justified by the time-value of money notion that wise planners who have run the numbers know to be false. More than any other learning that will come from this segment, all estate planners need to embrace the one reality illustrated here: economically, the sooner a client can afford to pay wealth transfer tax, the better.

A final aspect is crystal ball gazing: Will an estate tax be due when S dies? If you practiced estate planning during the last decade you know that the uncertainty we came to live with probably is not yet resolved.

Notwithstanding any of the typical arguments in favor of deferring the payment of wealth transfer tax, there is no denying that optimum use of the marital deduction after sheltering D's unified credit causes some "estate stacking" in S's estate. D's marital bequest is taxed "on top" of any assets S already owns, which likely will result in a higher marginal rate of tax being imposed on D's bequest (provided we have any progression in the tax rates — under state law and after 2012 under the federal rules) and, therefore, more tax over both estates than if no marital deduction had been taken. This factor is exaggerated to the extent D's property appreciates during S's overlife, although the benefit of generating a new basis at S's death under §1014 minimizes this cost (this new basis is attributable to inclusion of D's property in S's gross estate because it qualified for the marital deduction in D's estate).

A second factor that may minimize the tax bite at S's later death is tax free dissipation of the wealth, either through consumption that does not leave value in S's estate for wealth transfer tax purposes, or gifts that exploit certain benefits, such as the tax exclusive computation of gift tax on gifts that avoid the gross up rule of §2035(b) or the gift tax annual and ed/med exclusions. Each exclusion affords an opportunity to reduce the amount subject to tax in S's estate even if S is unwilling to make large enough gifts to incur gift tax during life.

The Time-Value of Money Notion is Bizarre: This segment of these materials illustrates that the time-value of money concept — which encourages taxpayers to defer paying a tax liability and use the money they otherwise would have paid to the government to invest and make added money — does not work for wealth transfer tax purposes. This segment employs an example in which D's gross estate is $20 million and S's gross estate is $1 million. These are big numbers and may exceed the average planner's typical client net worth, but they illustrate several important factors. The truths shown here do not change in smaller estates. In all these illustrations assume that D and S both die when the basic exclusion amount is $5 million, sheltered by the unified credit after 2010 (and, to avoid confusion in these examples, no §2013 credit is illustrated until much later). The tax computations at the deaths of D followed by S (also assuming no changes in asset values) look like:

Portability	Optimum Marital	Equalizer Marital	
$20,000,000	$20,000,000	$20,000,000	D’s gross estate
(20,000,000)	(15,000,000)	(9,500,000)	marital deduction
0	5,000,000	10,500,000	D’s taxable estate
0	1,730,800	3,655,800	tentative estate tax
(1,730,800)	(1,730,800)	(1,730,800)	unified credit
0	0	1,925,000	D’s FET payable
0	5,000,000	8,575,000	nonmarital trust after D’s taxes
When S later dies:			
$21,000,000	$16,000,000	10,500,000	S’s taxable estate
7,330,800	5,580,800	3,655,800	tentative estate tax
(3,461,600)	(1,730,800)	(1,730,800)	unified credit
3,869,200	3,850,000	1,925,000	S’s FET payable
3,869,200	3,850,000	3,850,000	total tax over both estates
17,130,800	17,150,000	17,150,000	assets remaining

As illustrated, in a flat tax world the optimum and equalizer approaches generate no tax difference over both estates. And the portability illustration, in which D qualifies D’s entire estate for the marital deduction and D’s estate makes the §2010(c)(5)(A) election, saves no tax in D’s estate relative to the optimum marital and it results in a $19,200 increase in the aggregate tax incurred, as compared to either the optimum or the equalizer marital.[4] But what about deferral so the estate can make money on the $1,925,000 otherwise payable at D’s death in the equalizer example?

Time-Value Example: Will the income earned in the optimum example on the estate tax that would be paid in D’s estate in the equalizer example constitute an advantage for the optimum alternative?

Many people assume that the optimum plan is preferable if S outlives D by a sufficient period of time. A number of factors are relevant for illustration purposes, including S’s health and overlife expectancy, the likely after tax return on the deferred taxes (which in turn depends on general rates of return and S’s income tax bracket), the effect of inflation, appreciation, and income accumulations that will increase (and invasions or depreciation that will dissipate) S’s estate, and the effect of other credits that may apply in one estate or the other. To minimize the effect of guesswork, the following illustration eases the analysis by assuming that all the variables come together during S’s overlife so that between the deaths of D and S all property values double, which reflects the use of the money during S’s overlife. The same computations when S later dies now reveal:

4. To appreciate the significance of these results requires an appreciation that the only saving would be attributable to a “full bracket run” in D’s estate, which is the $19,200 “loss” in the portability illustration. But as between the other two options there is no difference in today's flat tax environment.

Portability	Optimum Marital	Equalizer Marital	
$21,000,000	$16,000,000	$10,500,000	S's gross estate
×2	×2	×2	
$42,000,000	$32,000,000	21,000,000	S's taxable estate
14,680,800	11,180,800	7,330,800	tentative estate tax
(3,461,600)	(1,730,800)	(1,730,800)	unified credit[5]
11,219,200	9,450,000	5,600,000	S's FET payable
30,780,800	22,550,000	15,400,000	amount of marital trust remaining after S's taxes
0	10,000,000	17,150,000	double the amount of nonmarital trust remaining after D's taxes
30,780,800	32,550,000	32,550,000	assets remaining

The portability result is attributable to two negative factors. One is $1,750,000 of tax on $5 million of appreciation that could have been avoided if D had utilized a nonmarital trust to shelter that appreciation from inclusion in S's gross estate. The other is $19,200 of added tax attributable to taxing D's estate at a flat 35% on top of S's estate, rather than taking advantage of a full bracket run in D's taxable estate.

As between the other two options, the time-value assumption is that the optimum marital approach would be more beneficial because S can invest and reinvest the $1,925,000 of tax dollars not otherwise paid during S's overlife. This example illustrates that the time-value bromide regarding these alternatives is wrong. Indeed, in a progressive tax rate world the equalizer actually produces *better* results.

Note the assumption that income earned is the same as gain generated in measuring the time-value of the deferred taxes under the optimum marital approach. This equation is contrary to many planners' expectation, probably because of historical notions regarding fiduciary accounting and investment standards that treat growth in the form of appreciation as different from growth in the form of income generated. As illustrated by the Uniform Prudent Investor Act and various state fiduciary laws that embrace the portfolio theory of investment prudence, however, planners should not think of income and growth as different items for time-value analysis. They are merely two different ways to earn money with the assets that are available, both appropriate under a total portfolio performance standard. Moreover, unless S expends greater income in ways that generate no net worth increase at S's death, the fact that income would be paid to S while gain would increase the trust corpus also does not alter the equation.

Under this analysis, the combination of income and growth — total portfolio performance — is considered as one element. Properly considered, here it illustrates that traditional notions about the time-value of taxes deferred from the death of D to the death of S and about an optimum approach being more economical is a fallacy. There may be other legitimate reasons for deferring the payment of estate tax in the combined estates of D and S, such as lack of liquidity or fear about too little wealth remaining for S to live on, but a decision to defer taxes through use of an optimum marital bequest cannot be supported by the time-value notion.

5. Again assuming deaths in 2011, now in S's estate. This would produce a §2013 previously taxed property credit that, if illustrated, would preclude an apples to apples comparison. So it is ignored. But that added factor will further support the absolute advantage of being in the equalizer column instead of using either the optimum or the portability approach.

As illustrated, portability suffers if appreciation is expected. The converse would be true if depreciation is expected and cannot be avoided (for example, because the investment portfolio is not liquid, the entire economy tanks and there is no place to hide, or the decline is attributable to tax-free dissipation or consumption during S's overlife). In this example assume that values decline 50% during S's overlife.

Portability	Optimum Marital	Equalizer Marital	
$20,000,000	$20,000,000	$20,000,000	D's gross estate
(20,000,000)	(15,000,000)	(9,500,000)	marital deduction
0	5,000,000	10,500,000	D's taxable estate
0	1,730,800	3,655,800	tentative estate tax
(1,730,800)	(1,730,800)	(1,730,800)	unified credit
0	0	1,925,000	D's FET payable
0	5,000,000	8,575,000	amount of nonmarital trust remaining after D's taxes
When S later dies:			
$10,500,000	$8,000,000	5,250,000	S's taxable estate
3,655,800	2,780,800	1,818,300	tentative estate tax
(3,461,600)	(1,730,800)	(1,730,800)	unified credit
194,200	1,050,000	87,500	S's FET payable
0	2,500,000	4,287,500	50% of nonmarital trust
10,305,800	9,450,000	9,450,000	assets remaining

The differential in the portability column is an advantage of $855,800. This represents $19,200 more tax due to loss of the bracket run in D's estate, and $875,000 less tax because $5 million of nonmarital wealth was taxed in the other two examples but only $2.5 million was taxed in the portability example, due to the loss of 50% of the value during S's overlife. The tax at 35% on $2.5 million is $875,000.

There is a cost of losing the §1014 basis adjustment on more property at S's death if the nonmarital trust was $5,000,000 and doubles in value. So an estate with great appreciation potential raises planning considerations that require an analysis of D's portfolio and whether there are sufficient nonappreciating assets to pay the tax incurred at D's death in a less than optimum bequest situation. This next illustration shows that use of "hot" assets to pay the tax in D's estate reduces the resulting saving.

Under selective facts a more compelling case for either prepayment or deferral may arise. For example, an estate with great but only select income generation or appreciation potential raises new considerations that require an analysis of D's portfolio and whether there are sufficient nonappreciating assets to pay the tax incurred at D's death in a less than optimum bequest situation. This is because use of "hot" (highly appreciating) assets to pay the tax in D's estate reduces the resulting saving, as illustrated again by two examples. Both illustrations assume that D will bequeath to S an amount that, along with S's $1 million, will total $5 million at S's death and thereby take advantage of S's unified credit on the second death:

> *All Hot Example*: D's estate of $20 million consists entirely of highly appreciating assets. Although it is unrealistic, assume for calculation purposes that it is possible to predict with precision that every dollar will double during S's overlife. So D's estate qualifies $2 million for the marital deduction and pays $4,550,000 of tax on the remaining $18 million that will pass to a nonmarital trust. The $2 million marital doubles in value and, combined with S's own $1 million, is entirely sheltered from tax

when S dies. The $13,450,000 remaining in the nonmarital trust also doubles in value to $26,900,000 during S's overlife. An aggregate of $31,900,000 would remain at S's death, with no more wealth transfer tax to be paid.[6]

If, instead, D's estate paid no tax at D's death because it utilized traditional optimum marital deduction planning, the marital deduction would be $15 million, the nonmarital would be $5 million, and again the entire $20 million doubled in value during S's overlife, a tax of $9,100,000 would be incurred on the $31 million includible in S's estate at death (assuming a traditional nonmarital plan sheltered $5 million at D's death that doubled in value to $10 million) leaving the same $31,900,000 after S's death.

Prepay All Tax		**All Hot Example**	Defer All Tax	
Marital	Nonmarital		Marital	Nonmarital
$2,000,000	$18,000,000	D's estate	$15,000,000	$5,000,000
0	(4,555,000)	D's FET payable	0	0
2,000,000	13,450,000	D's post tax wealth	15,000,000	5,000,000
2,000,000	13,450,000	×2 appreciation	15,000,000	5,000,000
4,000,000	26,900,000	D's wealth when S dies	30,000,000	10,000,000
1,000,000	0	S's other wealth	1,000,000	0
5,000,000	0	S's taxable estate	31,000,000	0
0	0	S's FET payable	(9,100,000)	0
5,000,000	26,900,000	assets remaining	21,900,000	10,000,000
31,900,000		aggregate wealth	31,900,000	

Half Hot Example: Consider what happens instead if D's estate paid tax with assets that would not grow in value, to protect appreciating assets from later tax. To wit, assume D's $20 million estate consists of equal parts of highly appreciating and nonappreciating assets. D's estate qualifies $4 million of the nonappreciating assets for the marital deduction and pays $3,850,000 of tax on the remaining $16 million of nonmarital wealth. The estate pays this tax out of the remaining $6 million of nonappreciating assets, to shelter all the growth on the $10 million of appreciating assets. When S dies the $4 million marital trust has not changed in value and S pays no tax on that plus S's $1 million (instead, it simply absorbs S's unified credit) and the nonmarital trust is worth $22,150,000 ($10 million of the original value doubled, plus the $2,150,000 of nonappreciating property remaining after paying the tax in D's estate). This full amount also passes tax free at S's death, for a total of $27,150,000 after all tax is paid. If D's estate had paid no tax at D's death, $5 million of appreciating assets would have been sheltered in the nonmarital trust and would have grown to $10 million tax free at S's death. The remaining $5 million of appreciating assets would qualify for the marital deduction and be worth $10 million at S's death,

6. Remember, however, that a capital gains tax may be incurred on a subsequent realization event because, as nonmarital property that is not includible in S's gross estate at death, this property will not receive a new basis to eliminate that appreciation for future income tax purposes. The significance of this factor is uncertain because S's beneficiaries may never sell the asset, may do so when there are losses to offset against the gain, and Congress may bow to pressure from tax policy theorists and repeal §1014 before S dies, thereby denying the basis adjustment even in the optimum marital situation.

includible in S's gross estate, along with S's $1 million the remaining $10 million of D's estate that consisted of nonappreciating assets. Now only $25,400,000 would remain after incurring $5,600,000 of tax at S's death.

Prepay All Tax		**Half Hot Example**	Defer All Tax	
Marital	Nonmarital		Marital	Nonmarital
0	$10,000,000	D's hot assets	5,000,000	$5,000,000
$4,000,000	6,000,000	D's not hot assets	10,000,000	
0	(3,850,000)	D's FET payable	0	0
4,000,000	12,150,000	D's post tax wealth	15,000,000	5,000,000
	10,000,000	×2 appreciation	5,000,000	5,000,000
4,000,000	22,150,000	D's wealth when S dies	20,000,000	10,000,000
1,000,000		S's other wealth	1,000,000	
5,000,000		S's taxable estate	21,000,000	
0	0	S's FET payable	(5,600,000)	
5,000,000	22,150,000	assets remaining	20,400,000	5,000,000
27,150,000		aggregate wealth	25,400,000	

The saving attributable to prepayment is $1,750,000 over the optimum marital that defers all taxes. It represents avoidance of a 35% tax on $5 million of growth that was includible in S's taxable estate in the defer tax alternative. This saving is attractive enough to D in terms of prepaying $3,850,000 in tax at D's death rather than at S's death, especially because the assets used to pay that tax would not appreciate during S's overlife. And the example illustrates an unexpected reality that reveals factors that must be considered. If D's estate has a ready source of funds, such as an insurance trust that will collect the proceeds of insurance on D's life or other nonappreciating liquid assets, the situation may be ripe for the payment of some tax at D's death to shelter appreciating assets during S's overlife.

§*2013 Credit Maximizing Example*: Postmortem planning of the size of the marital deduction also should consider the effect of a §2013 credit for previously taxed property, if S is expected to die within 10 years after D's death (and especially in the unfortunate case in which S already has died before the marital deduction has been claimed on D's Form 706).

For example, in Technical Advice Memorandum 8512004, D left a will that bequeathed to S an amount equal to the maximum marital deduction allowable to D's estate, and bequeathed D's residuary estate to a nonmarital trust that gave S an income interest for life. S died three months after D, from causes not foreseeable at D's death. S's personal representative disclaimed the marital deduction bequest, with the result that D's entire estate passed under the residuary clause to the nonmarital trust. This meant that no marital deduction was available to D's estate.

Aggregate estate taxes over both estates were minimized, however, because the estate tax generated in D's estate increased the amount of the §2013 credit available in S's estate. This was because S's income interest in the nonmarital trust was sufficient to qualify for a §2013 credit notwithstanding that no part of that trust was includible in S's estate at death (and notwithstanding the nondeductible terminable interest rule for marital deduction purposes).[7]

7. Estate of Weinstein v. United States, 820 F.2d 201 (6th Cir. 1987), and Technical Advice Memorandum 8608002 illustrate that this technique may succeed even if income is payable only in the trustee's discretion rather

Under the actuarial tables, the value of S's life income interest (and the §2013 credit based thereon), was far in excess of the income actually received by S during the three months that S survived D. Nevertheless, because Rev. Rul. 80-80, 1980-1 C.B. 194, required use of the actuarial tables (because S's death was not clearly imminent due to an incurable physical condition that was known at D's death), S's estate was able to maximize the credit at a nominal cost. The same result would be reached today under the §7520 regulations. In a less well planned manner, essentially this is what generated a sizeable savings in Estate of Howard v. Commissioner, 91 T.C. 329 (1988), and was the opportunity at stake in the simultaneous death cases of Estate of Carter v. United States, 90-1 U.S. Tax Cas. (CCH) ¶60,003 (E.D. La. 1989), rev'd, 921 F.2d 63 (5th Cir. 1991), and Estate of Marks v. Commissioner, 94 T.C. 720 (1990), these three cases involving tax savings of approximately $600,000, $300,000 and $200,000, respectively.

This being the case, some planning choices need to be made inter vivos, such as whether the death of both spouses within 10 years of each other is sufficiently likely that planning the nonmarital trust to maximize the value of S's income interest is better than use of an accumulation or spray trust. Addition of a five or five withdrawal power will further maximize the value of S's nonmarital trust interest for §2013 planning. See, e.g., Estate of Shapiro v. Commissioner, 66 T.C.M. (CCH) 1067 (1993) (91 year old S died within five months of D; five or five power added 13.5% to value of lifetime annuity). In a recent calculation with a 77 year old S the five or five power added over 22% in value to the life estate calculation.

Example: D has an estate of $20.0 million and S has an estate of $1 million. S dies within nine months after D's death but, because S was not terminally ill when D died, valuation of S's life estate in D's property is based on the actuarial tables, as required by §7520 and Treas. Reg. §20.7520-3(b)(3). Using 2011 rates and credits:

Optimum Marital		§2013 Maximizing Marital
$20,000,000	D's gross estate	$20,000,000
(15,000,000)	marital deduction	(7,691,030)
5,000,000	D's taxable estate	12,308,870
0	D's federal estate tax	2,558,140
16,000,000	S's taxable estate	8,691,030
3,850,000	S's tax before §2013 credit	1,291,861
0	§2013 credit	(1,291,861)
3,850,000	S's tax after §2013 credit	0
3,850,000	tax over both estates	2,558,140

The §2013 credit was computed based on S's life estate being worth 50.5% ($4,924,170) of the $9,750,831 nonmarital trust after paying $2,558,140 in tax. The assumptions underlying this computation will change monthly with the §7520 interest rate and annually with S's age. To make this hypothetical computation the assumptions made were that S is age 80, the §7520 rate is 3.0%, and S is given a five or five power of withdrawal over the nonmarital trust.

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than as an absolute entitlement of the surviving spouse. However, Technical Advice Memoranda 8717006 and 8944005 denied the credit for discretionary income interests, so the better approach is to guarantee income to the survivor.

Notice that no state death tax, nor the §2058 state death tax deduction, is reflected in this calculation, on the theory that there would be no state death tax if there is no federal estate tax payable after the §2013 credit is applied. That concept is not universally accepted, but was recognized as proper in a §2011 pick-up tax environment by Comptroller v. Phillips, 865 A.2d 590 (Md. 2005), In re Estate of Lacks, 662 N.W.2d 54 (Mich. App. 2003), Riethmann Trust v. Director of Revenue, 62 S.W.3d 46 (Mo. 2001); In re Estate of Eberbach, 512 N.E.2d 902 (Ind. Tax Ct. 1987); Estate of Turner v. Washington State Dep't of Revenue, 724 P.2d 1013 (Wash. 1986), and Estate of Hemphill v. Washington State Dep't of Revenue, 105 P.2d 391 (Wash. 2005) (when the federal §2011 credit went to zero the state death tax did too); and Dickinson v. Maurer, 229 So. 2d 247 (Fla. 1969). With state tax variations in the wake of repeal of §2011 after 2004 it is impossible to generalize about how state death tax might be affected by such planning.

In this case D and S saved $1,291,860 in tax paid over both estates, representing a 33.5% tax saving (in this case, 6% of the aggregate wealth of D and S). This planning requires some balancing to ensure that S has sufficient assets to generate enough tax to consume the §2013 credit produced from the tax on D's estate, and D's estate is large enough to produce enough tax to generate the necessary credit. Several computations may be needed to strike the proper balance, and more computational complexity will be encountered if a state death tax is involved. Software *is* available to do the calculation.

Your Client Trusts the Surviving Spouse to Make Gifts

Everything seen so far illustrates the *second* best manner to move wealth. Unless everything changes with repeal of the estate tax (and preservation of the gift tax) the better mechanism for moving property to the next generation at the lowest aggregate tax cost to spouses is to give S the full optimum marital deduction amount needed to avoid tax in D's estate, and then have S immediately make gifts to the same beneficiaries who would benefit from a larger nonmarital trust. Similarly, having S make a *non*qualified disclaimer from D's estate would produce the same preferable results. This is true because, even if S is in the highest marginal bracket for gift tax purposes, the effect of the tax exclusive calculation of the gift tax means that the effective tax rate on gifts made by S is less than the lowest rate that could be incurred on the same property in D's estate.

To illustrate, assume S receives $1 million more property from D than S needs, and that S is willing to part with that amount in the form of a gift to children and the gift tax thereon. If S's marginal gift tax bracket is 35%, S could transfer $740,740 from the $1 million that S does not need; at 35% the tax on this gift would equal the remaining $259,260 that S will pay to the government (assuming no unified credit is available because, in this case, S already has made sufficient gifts to run through the brackets and in the process used the full credit).[8] This 25.93% tax rate on the $1 million that S was willing to part with is less than the 35% flat tax that could have been incurred in D's estate if a less than optimum marital bequest is utilized.

The risk to consider is that S will not live three years after making the gift and the gross up rule of §2035(b) will apply. Like other aspects of postmortem planning to minimize the aggregate tax burden imposed on spouses, this concept also requires a little crystal ball gazing. If living three years appears to be a bad gamble, however, the alternative that should be considered seriously is §2013 planning.

8. The algebraic formula to make this computation is: transfer ÷ 1 + tax rate = taxable gift

So: $1 million ÷ 1.35 = $740,740

To confront all these risks and opportunities, the plan that makes sense for family and tax planning purposes is to create a QTIPable trust that pays all income to S so that, if a postmortem partial QTIP election is made to incur some tax in D's estate, a full §2013 credit will be available based on the income interest granted to S. And to permit gifting, grant S a power to withdraw from the QTIP marital beginning after some delay — making this a QTIP trust and not a §2056(b)(5) trust (which would not affect the marital deduction but it might deny the partial QTIP election ability if the power were available earlier — because the (b)(5) marital is automatic).

The withdrawal power grants the ability to make the inter vivos gifts, which is the second aspect of the plan that makes sense. Notice, however, that the withdrawal power raises the unanswerable issue whether inclusion when S dies will be under §2041 or §2044, which is relevant only in terms of the different §§2207 and 2207A rights of reimbursement — and this may not be relevant if S's tax payment provision is drafted properly.[9]

There is a capital gain issue involved if S makes gifts of appreciating property rather than holding them until S dies to permit a §1014 basis adjustment at S's later death, but pushing the pencil will show that the new basis at S's death (avoiding a typical, potential *worst case* 20% capital gain tax) may not make up for the tax saving attributable to making the gift. The differential in tax will be a minimum 9.1% — between a 35% estate tax and a 25.93% maximum effective gift tax.

The gift may fall behind holding property until S dies if S dies within three years after making the gift, §2035(b) therefore applies, and low basis assets must be sold to generate liquidity to pay the estate tax generated by that event. Usually the assets used by S's estate to pay the tax attributable to that event receive a basis adjustment at S's death, so this would be relevant only if transferee liability is imposed on S's donees who hold low basis property — not a very likely scenario. Otherwise, holding property until death to garner the new basis under §1014 may be a fool's errand — it may not compensate for the gift tax saving otherwise available.

Given these advantages of lifetime giving by S, an appropriate question is why more plans do not grant S the power to make gifts. Indeed, quaere whether most estate planners even ask their married clients whether they trust giving the survivor of them the power to make gifts. One frequently heard response is that one spouse fears that the other spouse will remarry and disinherit their children in favor of their new spouse. As confirmed by statistics (and probably also undeniable in practice experience), the likelihood of a surviving widower remarrying after the death of his wife is 2.5 times greater than the likelihood of a surviving widow remarrying.[10]

Although these statistics do not show how often remarried spouses disinherit their children by former marriages in favor of new spouses, most estate planners of any experience will confirm that surviving remarried widows seldom engage in this planning, whereas surviving remarried widowers do so with much greater frequency. So, if control over D's wealth is a problem, it ought to be the wife who articulates the concern, and then only if the husband is likely to be the survivor and has the smaller estate (meaning there is sense in a marital deduction bequest), which isn't yet the normal paradigm for planning purposes. Instead, in the

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9. See Pennell, TRANSFER TAX PAYMENT AND APPORTIONMENT, 834-2d Estates, Gifts, and Trusts Portfolio (Tax Mgmt. 2011).

10. A 1989 study cited by Waggoner, *Marital Property Rights in Transition,* 59 MO. L. REV. 21 at 49 n.71 (1994), reveals that only 8% of all surviving widows remarry and that they wait an average of 8 years before doing so, whereas over 20% of all widowers remarry and in less than 4 years on average. In the time since that study do you think these numbers have gotten more or less dramatic?

more common but opposite situation, the statement of fear about remarriage probably is a manifestation of what the husband would do if he survived rather than a legitimate fear of what the wife is likely to do if she survives and has the power to withdraw corpus to make gifts.

The bottom line is that, with the advantages to be gleaned from inter vivos giving by S, the estate planner owes it to the couple to at least explore the notion of giving S the discretion to make gifts. Unfortunately, due to the prohibition in §2056(b)(7)(B)(ii)(II) against anyone, including S, having an inter vivos power to appoint QTIP property, this form of planning cannot be accomplished with an inter vivos nongeneral power of appointment and instead requires either that the trustee make distributions to S (without condition on how S may use that wealth) or that S be given the authority to withdraw corpus from the trust and, in either case, independently make a gift to anyone S chooses.

The previous discussion illustrated just one of several advantages traditionally associated with inter vivos giving: the tax exclusive computation of the gift tax. Other advantages routinely noted for inter vivos transfers are the gift tax annual and ed/med exclusions, shifting future growth, and shifting future income. If the tax remains a flat rate proposition, shifting appreciation no longer will make sense,[11] but those other opportunities will remain — none will be offset by the improper time-value of money notion. Moreover, there are other advantages to inter vivos transfers of wealth, such as valuation differences between the estate and gift taxes. For our purposes, however, that topic can be addressed on another day.

Summary

This essay illustrates several options that inform a prescription for planning in uncertain times, such as currently exist.

First, there is no reason to decline making gifts, if they make sense for traditional gifting reasons.

Second, formula provisions continue to make sense, especially if they can be adjusted postmortem, such as with partial QTIP or reverse QTIP elections.

Third, drafting to permit a nonmarital trust to qualify for either the state or federal marital deduction by making a QTIP election also adds desirable flexibility.

Fourth, the plan should be drafted to take advantage of portability of D's unused exclusion amount, even if that option appears to be second best planning.

Fifth, be open to using a combination of postmortem options, rather than taking an all-or-nothing approach — such as planning that shelters a portion of D's unified credit in a traditional nonmarital trust and then elects portability of the balance of D's exclusion amount, or half-hot style planning that incurs taxes based on the mix and liquidity of assets that are available to pay estate taxes.

Finally, draft to benefit from the §2013 credit if the order of deaths makes it viable.

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11. For example, if S's wealth totals $2x and the flat tax rate was 35%, a tax of $.70x could be paid presently, leaving $1.30x. If the $2x were to triple in value before tax is incurred, $6x would incur $2.1x of tax, leaving $3.9x after S's death. Had the tax been paid earlier (that is, if an estate freeze had been performed), the remaining $1.30x would have tripled to the same $3.9x, making the freeze a zero sum game in terms of shifting appreciation.