

# BUSINESS

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## New Laws Complicate Estate Planning

**Taxes: Higher limits on amounts that may be placed in trusts could leave some heirs with little or nothing.**

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Thanks to recent changes in the nation's tax laws, two popular estate-planning techniques could backfire on married couples and grandparents who don't update their wills or living trusts, estate tax experts say.

The changes, which were part of the \$1.35-trillion tax cut signed by President Bush in June, could result in too much or too little money being left to certain heirs, estate planners said. Some heirs also could be left with an unexpectedly large income tax bill if individual retirement accounts are involved.

"The biggest danger is that surviving spouses could be left out in the cold . . . or that grandchildren would end up with all the money" intended for other heirs, said Blanche Lark Christerson, a director at Bankers Trust Private Banking.

The changes affect two kinds of trusts designed to save on estate taxes: credit shelter trusts, which are commonly used by married couples, and generation-skipping trusts, which are typically used by grandparents to pass money on to their grandchildren.

Both trusts are designed to take advantage of the maximum amount of money that is allowed to pass tax-free to heirs.

Credit shelter trusts, for example, often require that an amount equal to the prevailing estate tax exclusion limit—currently \$675,000—be placed in a trust for eventual distribution to the couple's children after the surviving spouse dies. The survivor may be allowed to receive income from the trust but has only limited rights to tap the principal.

Credit shelter trusts are part of most professionally drafted estate plans for married couples, but they also can be used by unmarried people who want to give a surviving partner or other person income from a trust, with the principal later going to other heirs, attorneys said.

The main advantage of credit shelter trusts is that the amount in the trust can continue to grow without incurring estate taxes on the survivor's death.

But the new law increases the estate tax exclusion limit to \$1 million next year and \$3.5 million by 2009. That means the amount going into the trust could be far more than people originally intended, Christerson said.

In the worst-case scenario, a surviving spouse could be left with too little money to live on, said Elizabeth T. Pierson, a Los Angeles estate planning attorney. Some states allow widows and widowers to override wills that don't give them enough money. But in California, the survivor would have to go to court to try to undo the trust, Pierson said.

The problem doesn't disappear in 2010, when the estate tax is scheduled to be repealed. Depending on how the trust is worded, either the entire estate, or none of it, could go into the trust.

If the estate documents say that the trust should be given the maximum amount of money that can pass tax-free to heirs, all the bequeathed property could be locked up in the credit shelter trust, since entire estates would be allowed to pass tax free in 2010, Christerson said.

By contrast, if the estate documents say that only the amount of the current exclusion limit can go into the trust, no money would go into the trust if the person dies when there is no limit in 2010.

That could be a problem if the estate tax later returns—as it is scheduled to do in 2011—and the family misses out on the opportunity to shelter assets from future taxes, said Michael B. Allmon, a Los Angeles certified public accountant.

Because of sunset provisions, the repeal is scheduled to end on Dec. 31, 2010, when the exclusion limit returns to \$1 million. These changes, and the possibility that Congress will alter the rules yet again in coming years, mean people should review their estate planning documents regularly over the next few years, said Jon J. Gallo, a Los Angeles estate planning attorney.

Another problem is that the rising exemption limit could end up snagging an IRA if there aren't enough other assets to put in the trust, said Bruno Graziano, an estate tax expert at tax research firm CCH Inc. of Riverwoods, Ill.

Estate planners typically avoid placing IRAs in credit shelter trusts, because doing so often requires heirs to take income from the retirement account—and pay taxes on that income—more quickly than if the account had been inherited directly, Graziano said.

But estates may be forced to include IRAs if the trust is tied to the higher exemption amount and the estate runs out of other assets to place in the trust, or is required to put all the assets in the trust, he said.

The estate tax is not the only death-related tax scheduled to disappear and then come back. The generation-skipping transfer tax also is supposed to be phased out over the next nine years before returning in 2011, which could have repercussions for many estates that have trusts designed to benefit grandchildren, planners said.

Like credit shelter trusts, generation-skipping trusts are designed to provide income to one set of beneficiaries—typically the creators' children—with the principal eventually going tax-free to another set—typically the creators' grandchildren.

Unlike credit shelter trusts, however, generation-skipping trusts aren't tied to the estate tax exclusion amount. Instead, they are typically tied to the amount that es-

capates the generation-skipping tax, which is now imposed on any transfers of more than \$1.06 million that "skip" over an intervening generation—such as from grandparent to grandchild.

The amount that avoids generation-skipping taxes increases to \$1.5 million in 2004, \$2 million in 2006 and \$3.5 million in 2009 before the tax is repealed entirely in 2010. Again, that could mean that far more of a grandparent's estate could wind up in a generation-skipping trust than originally intended if the formula creating the trust is tied to the maximum amount that escapes the tax, estate planners said.

People whose estate plans include credit shelter or generation-skipping trusts would be wise to review their documents in light of the tax law changes, said Los Angeles estate planning attorney Burton A. Mitchell. Mitchell said his clients' documents typically include caps that limit the amount that can be put into such trusts.