



## Estate Planning Update

*November 30, 2010*

### **GIFT TAX SET TO INCREASE IN 2011 – CONSIDER 2010 GIFTS**

Lifetime gifts in excess of \$1,000,000 are subject to Federal gift tax. Absent new legislation, the maximum Federal gift tax rate will be 55% in 2011. By comparison, the maximum Federal gift tax rate in 2010 is 35%--the lowest rate since 1934.

The historically low Federal gift tax rate and concurrent lapse in Federal generation-skipping transfer (“GST”) tax in 2010 are good reasons to consider a gift before the end of the year. Loan forgiveness or direct gifts to grandchildren in 2010 are particularly tax efficient because not only does the donor take advantage of the low gift tax rate, but such planning also avoids the GST tax that a transfer to grandchildren in any other year would incur.

While the risk remains that new legislation will retroactively increase the 2010 gift tax rate and/or retroactively reinstate the GST tax, this possibility becomes more remote as the year draws to a close (and there are ways to structure gifts so as to attempt to limit the effect of any retroactive legislation).

### **INCOME TAX SET TO INCREASE IN 2011**

- **Consider Selling Appreciated Securities in 2010.** Individuals and Trustees should consider selling securities with gains before the end of 2010 to take advantage of the current Federal capital gains tax rate (the maximum rate for individuals and trusts will increase from 15% in 2010 to 20% in 2011).
- **Consider Roth IRA Conversions in 2010.** Beginning January 1, 2010, income level restrictions on converting a traditional IRA to a Roth IRA were eliminated; now anyone is eligible to convert a traditional IRA to a Roth IRA.<sup>1</sup> Individuals for whom conversion may make sense should consider doing the conversion in 2010 so that the tax on the income resulting from the rollover may be paid under the 2010 Federal ordinary income tax rates (the maximum rate is set to increase from 35% in 2010 to 39.6% in 2011). For individuals who prefer to defer the tax regardless of the rate change, 2010 conversions offer the option to pay half of the tax on the 2010 income tax return and half on the 2011 return.

### **LOW CURRENT INTEREST RATES – CONSIDER INTRA-FAMILY LOANS**

The IRS-mandated interest rate on loans to family members is unusually low at present (for December 2010, the rate is 1.53% for a loan with a term of between three and nine years with

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<sup>1</sup> Whether it makes sense for an individual to convert is best determined by a quantitative analysis of factors such as the age of the individual, current and projected future earnings, projected future Federal and local income tax rates, proposed use of the IRA assets, and the balance of the individual’s estate planning.

annual compounding). Low interest rates make this an appealing time to consider using loans as a wealth transfer technique—either by loaning money to family members or trusts for their benefit or by selling assets to family members or trusts in exchange for a note.

## **POSSIBLE GRAT LEGISLATION—CONSIDER CREATING GRATs**

Provisions restricting the Grantor Retained Annuity Trust (“GRAT”) technique were introduced or passed by the House of Representatives or Senate seven times thus far in 2010. While none of these attempts reached President Obama’s desk, recent history suggests that the restrictions will continue to be re-introduced and may ultimately be enacted into law. The new law likely would require any GRAT created after enactment to have a term of at least ten years and to result in a taxable gift on creation (the size of the required gift is unclear). Under current law, there is no minimum term and a GRAT can be created with little or no taxable gift.

In addition to taking advantage of the current rules governing GRATs, now is a good time to create GRATs because of the low interest rates and the potential to transfer assets with depressed values. In essence, GRATs transfer tax-free any appreciation on the gifted assets in excess of an IRS-mandated hurdle rate of return. The hurdle rate for December 2010 is 1.8%.

## **RETURN OF FEDERAL ESTATE TAX IN 2011**

Absent new legislation, the Federal estate tax will return in 2011 in the most burdensome form since 2000. The maximum Federal estate tax rate in 2011 will be 55% and the Federal applicable exclusion (the maximum amount that may be excluded from Federal estate tax) will be \$1 million for individuals dying in 2011.

The New York State applicable exclusion is also \$1 million and the highest marginal New York State estate tax rate is 16%. However, because a Federal credit is available for New York estate tax paid, the effective combined maximum Federal and New York State estate tax rate in 2011 will be 55%.<sup>2</sup>

## **FEDERAL GST TAX REINSTATED IN 2011; ALLOCATION OF GST TAX EXEMPTION**

Federal GST tax is a tax imposed on transfers by gift or upon death, or on transfers from trusts, to persons two or more generations below the person making the transfer or who created the trust. Following a lapse in 2010, the Federal GST tax will return in 2011 with a maximum rate of 55% and a \$1,340,000 exemption from GST tax for each individual, absent new legislation.

Each year, you should alert your accountant to transfers you make to trusts (including life insurance premiums paid with respect to insurance trusts) and determine whether you should opt out of, or into, allocation of GST tax exemption (and whether to opt out or in on a permanent basis) so that your gift tax return, which is due in the year following the year of

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<sup>2</sup> There will be an additional 5% Federal estate tax on the portion of the taxable estate between \$10,000,000 and \$17,184,000. If the total amount of the taxable estate is within this range, the effective combined maximum estate tax rate will be 60%. The effective combined maximum estate tax rate for estates over \$17,184,000 will be 55%.

transfer, can be prepared appropriately. Because of the 2010 lapse of the GST tax, allocation of exemption to transfers this year will require special analysis.

### **FEDERAL GIFT TAX ANNUAL EXCLUSION UNCHANGED FOR 2011; TUITION AND MEDICAL PAYMENTS**

The annual exclusion from Federal gift tax is \$13,000 per individual recipient. A married couple may continue to “split” all gifts on gift tax returns for the year and may give a total of \$26,000 gift-tax free to any number of individual recipients.

In addition to the annual exclusion, there continues to be an exclusion from Federal gift tax for payment of another person’s tuition or medical expenses (including medical insurance premiums), provided that the payment is made directly to the institution providing education or directly to the health care provider. This exclusion is unlimited both with respect to the amount of the payment and the number of allowable recipients.

### **NEW FILING REQUIREMENT FOR NEW YORK RESIDENT TRUSTS NOT SUBJECT TO TAX**

Many trusts created by New Yorkers are now required to make annual income tax filings, even where the trust is not subject to New York State tax. Trustees of trusts created by New Yorkers should consult with their accountants to ensure all proper filings are made.

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If you have any questions or would like to discuss the ideas presented in this update in greater detail, please contact Pamela L. Rollins ([prollins@stblaw.com](mailto:prollins@stblaw.com); 212-455-3468), Laura M. Twomey ([ltwomey@stblaw.com](mailto:ltwomey@stblaw.com); 212-455-3120) or any other member of our Personal Planning Department.

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