



New Law Creates Estate Planning Opportunities

February 22, 2011

The new Federal tax law enacted on December 17, 2010 (the "Act") made important changes to the Federal estate, gift, and generation-skipping transfer ("GST") taxes. The Act provides significant new estate planning opportunities, but only for two years, as the law sunsets at the end of 2012. This memorandum highlights the changes and opportunities afforded by the Act.

GIFT AND GST TAX—USE INCREASED EXEMPTIONS IN 2011 AND 2012

The exemption from Federal gift and GST taxes increases to \$5,000,000 for 2011 and 2012 (adjusted for inflation in 2012), and both taxes are imposed at a top rate of 35% on transfers in excess of the \$5,000,000 exemption made during this two-year period. As under prior law, any gift tax exemption used during life reduces the estate tax exemption available at death. The \$5,000,000 exemptions are a substantial increase from the previous \$1,000,000 gift tax and \$3,500,000 GST tax exemption. However, after the Act sunsets at the end of 2012, the gift and GST tax exemptions will decrease to \$1,000,000 (with the GST exemption indexed for inflation), absent new legislation. For this reason, we recommend using the increased gift and GST tax exemptions this year and next while their availability is certain. The amount of each exemption now available to an individual is the balance of \$5,000,000 over any exemption amount used before 2011. Please note that even an individual who used his or her entire gift tax exemption and made taxable gifts prior to 2011 would still have the full \$4,000,000 balance of gift tax exemption remaining. In addition, because married couples may "split" gifts, a \$10,000,000 combined gift tax exemption is available to a married couple during this two-year period, reduced by prior use of exemption, and one spouse's property may be used to fund the gift, with the other spouse signifying consent to use his or her exemption.

Making a gift to a trust for the benefit of descendants and then lending or selling assets to the trust in exchange for a note allows for enhancement of the transfer tax savings on the gift because to the extent that the trust's investments outperform the IRS-required interest rate (2.33% for loan with a term of between 3 and 9 years with annual compounding made in February 2011), income and appreciation attributable to the loaned assets will accrue to the benefit of descendants free of transfer taxes.

We believe there are many advantages to gifting the \$5,000,000 exemption now, but we note there is some debate as to the treatment of lifetime gifts of \$5,000,000 in the estate of a person who passes away at a time when the estate tax exemption is less than \$5,000,000. We would be happy to discuss in further detail all of the considerations of utilizing the new increased exemption in 2011 or 2012.

ESTATE TAX

The exemption from Federal estate tax increases to \$5,000,000 for 2011 and 2012 (adjusted for inflation in 2012), and the top estate tax rate is 35% for this period. The Act also allows “portability” of the estate tax exemption, which means that the executor of the estate of an individual dying in 2011 or 2012 can transfer any of the decedent’s unused estate tax exemption to his or her surviving spouse, which would allow the full use of both spouses’ estate tax exemptions at the death of the surviving spouse (by contrast, portability does not apply to an individual’s GST exemption amount—such exemption expires at the individual’s death). However, after the Act sunsets at the end of 2012, portability will no longer be available, absent new legislation allowing it. For this reason, we continue to recommend that each spouse have sufficient assets to make use of his or her remaining estate tax exemption at his or her death, usually through the creation of a testamentary trust for the benefit of his or her surviving spouse and descendants. Please note that the New York State estate tax remains the same as before the Federal changes, with a \$1,000,000 exemption and a top rate of 16%.

We also recommend that each client consider how the increased exemption amounts may impact his or her existing Will. Given the substantial increase in the amount of the exemptions, it is important to consider whether bequests that are tied to the amount of the exemptions still meet the client’s objectives.

The following chart shows the Federal transfer tax exemptions and rates for the next three years, absent new legislation.

	2011 and 2012	2013 (absent new legislation)
Gift Tax Exemption	\$5,000,000 (inflation adjusted in 2012)	\$1,000,000
Gift Tax Rate	35%	55%
GST Tax Exemption	\$5,000,000 (inflation adjusted in 2012)	\$1,000,000 (inflation adjusted)
Top GST Tax Rate	35%	55%
Estate Tax Exemption	\$5,000,000 (inflation adjusted in 2012)	\$1,000,000
Top Estate Tax Rate	35%	55% ¹

¹ There is an additional 5% Federal estate tax on the portion of the taxable estate between \$10,000,000 and \$17,184,000.

TAX-FREE DISTRIBUTIONS FROM IRAS TO QUALIFYING CHARITIES

The Act provides an exclusion for 2010 and 2011 from gross income of up to \$100,000 per year of otherwise taxable distributions from IRAs made directly to qualifying charitable organizations. The following conditions must be met in order to take advantage of the exclusion: (i) the distributions must be to certain public charities (and notably, cannot be to donor-advised funds) and (ii) the IRA owner must have attained age 70½ at the time the distributions are made. Whether it makes sense to use this exclusion depends on a number of factors, including income level, assets available for charitable giving, and the individual's level of charitable giving.

GRAT TECHNIQUE CONTINUES TO BE FAVORABLE

Despite numerous attempts earlier in 2010 to enact legislation restricting the Grantor Retained Annuity Trust ("GRAT") technique, the Act contained no such provision. Accordingly, GRATs continue to be an attractive estate planning option in light of the current favorable GRAT rules and low interest rates. The charitable analog of the GRAT—the Charitable Lead Annuity Trust ("CLAT", identical to the GRAT except that the annuity passes to charity instead of to the donor) also remains appealing in the low interest rate environment.

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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; 212-455-3468), Laura M. Twomey (ltwomey@stblaw.com; 212-455-3120) or any other member of our Personal Planning Department.

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