



2010 END OF YEAR ESTATE PLANNING

We wrote in January 2010 about the failure of Congress to pass estate tax legislation in 2009. As of this date, Congress still has not passed legislation. Due to such Congressional inaction, there are planning opportunities this year that may never return. This is especially true given the current low valuation of assets. There is always the possibility that Congress could pass legislation and attempt to have it apply retroactively, though it is unclear whether that would be constitutionally permissible. For clients who are interested in making taxable gifts as discussed below, we recommend that you contact us soon to start the process. However, given the possibility of retroactively applied legislation, we recommend that these plans not be implemented until close to year end.

Lifetime Gifts

The gift tax exemption for taxable gifts (i.e., gifts which do not qualify for exclusions) is \$1,000,000. This exemption has not changed since 2001 and will not change in 2011 assuming no legislative changes are made. The gift tax rates for taxable gifts which exceed the exemption amount have changed. For 2010 only, the gift tax rate is 35% (due April 15, 2011). Gift tax rates are unlikely to be lower in the future. In contrast, for gifts made in 2009, the highest marginal gift tax rate was 45% and, assuming there is no change in the law, for gifts made in 2011, the highest marginal gift tax rate will be 55%. For clients who have already made taxable gifts and would like to further reduce their estate, this is a relatively inexpensive way to do so. It also remains the case that the gift tax can be less expensive than estate tax because the payment of gift tax reduces the estate.

Lifetime Gifts to Grandchildren and Trust Distributions to Grandchildren

For 2010 only, gifts made outright to grandchildren (or lower generations) will not be subject to generation skipping transfer (GST) tax. For 2010 only, there also will be no GST tax on distributions to such persons from irrevocable trusts otherwise not exempt from GST tax (assuming such distributions are allowed under the trust instrument). In contrast, in 2009, there was a GST exemption of \$3,500,000 and a 45% GST tax rate for gifts over the exemption amount, and assuming there is no change in the law, in 2011, there will be a GST exemption of around \$1,350,000 (\$1 million indexed for inflation) and a 55% GST tax rate. This is in addition to any applicable gift taxes (though the client would be able to use his gift tax exemption first). The benefit of such gifts is that they "skip" the preceding generation so they save estate tax for the members of that generation.

Thus, for 2010, taxable gifts over the \$1,000,000 gift tax exemption to grandchildren (or lower generations) will be subject to a 35% gift tax, instead of gift tax and GST tax in future years.

Please keep in mind that, given the possibility that future estate tax exemption amounts may be greatly increased (or that the federal estate tax could be eliminated), there is a risk that gift tax will be paid unnecessarily. In addition, for income tax purposes, the donee of any gift will have the same basis as the donor of the gift. Assets retained until death, on the other hand, will receive a step-up in basis to date of death value after 2010.

GRAT Proposal

Unrelated to the year end gifting opportunities discussed above, there is recent proposed legislation regarding grantor retained annuity trusts (GRATs). A GRAT is a trust which pays to the donor a specified dollar amount for a term of years, and after the end of the term, the GRAT terminates in favor of children or other beneficiaries. It is a technique used where the donor expects the asset in the GRAT to greatly increase in value. This technique is particularly attractive due to the historically low IRS interest rate that is used to determine the gift. The grantor must survive the term in order for the asset to not be taxed in his estate. Basically, the grantor can pass the post-gift appreciation in the asset to the beneficiaries without paying any gift tax. Under current law, the GRAT term can be any number of years. The proposal would require a minimum ten year term. Clients who are interested in GRATs would be advised to act soon.

We look forward to hearing from you.

The information contained herein is general in nature. This information is not intended and should not be construed as legal advice and should not be relied upon in any specific situation without appropriate legal advice.

IRS Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments or enclosures) is not intended or written, and cannot be used, for the purpose of (a) avoiding penalties under the internal revenue code or (b) promoting, marketing or recommending to another party any transaction or matter addressed herein.