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Summary Of The New Gift, Estate And Generation Skipping Transfer Tax And Important Planning Opportunities Before The End Of 2010

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act") which, among other things, temporarily reforms the Federal Estate, Gift and Generation-Skipping Transfer ("GST") Tax laws retroactively to January 1, 2010 and until December 31, 2012. Under prior law, the Federal Estate and GST Taxes were repealed for one year starting January 1, 2010, and on January 1, 2011 both taxes were scheduled to return at pre-2001 tax rates and exemption levels. Below is a brief summary of the Act **and some planning opportunities which require action before January 1, 2011.** We will be issuing a follow up alert early in the New Year with planning opportunities for 2011.

Changes for 2010

- The lifetime Federal exemption for Gift Tax purposes remains at $1,000,000 with a tax rate of 35% for transfers in excess of $1,000,000.
- Estates of decedents dying in 2010 will be subject to a Federal Estate Tax with a $5,000,000 exemption, a 35% tax rate and a stepped up tax basis. However, an executor may elect out of the Federal Estate Tax in which case there will be a carryover of basis for income tax purposes.
- Direct gifts to or in trust for grandchildren in 2010 will not be subject to the GST Tax (but will be subject to Gift Tax to the extent the donor exceeds his or her $1,000,000 lifetime gift exemption in 2010). However, taxpayers must file a Gift Tax return for 2010 to "elect out" of the automatic allocation of GST exemption. SEE PLANNING OPPORTUNITIES BELOW.
- The GST Tax exemption amount for 2010 is $5,000,000. This applies to transfers to grandchildren directly (if no "election out" is made) as well as to transfers to trusts that benefit both children and grandchildren and may therefore be subject to GST Tax in the future when the trust assets are ultimately distributed to grandchildren.
- For decedents dying after December 31, 2009 and prior to December 17, 2010, the deadlines for filing an estate tax return, filing a large estate return (if a decision is made to "elect out" of the Federal Estate Tax), paying estate taxes and making disclaimers are extended until September 17, 2011.

Changes for 2011

- The Federal Estate Tax exemption amount is increased to $5,000,000, adjusted for inflation in 2012. Any amount over the Estate Tax exemption amount is taxed at a rate of 35%.
- The Federal Estate, Gift and GST Taxes are once again unified, meaning that the lifetime exemption for Gift Tax purposes is also $5,000,000, with any lifetime transfers over that amount taxed at a rate of

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35%. For those clients who were considering making taxable gifts in 2010 to take advantage of the reduced Gift Tax rate of 35%, it will generally be more advantageous to wait until 2011 because of the $4,000,000 increase in the Gift Tax exemption. However, gifts to grandchildren on or before December 31, 2010 should be considered. SEE PLANNING OPPORTUNITIES BELOW.

- The GST Tax exemption amount will also be $5,000,000 for 2011, but will be indexed for inflation in 2012. The GST Tax rate will also be 35%.
- The Federal Estate, Gift and GST Tax exemptions will be portable between spouses. This means that a surviving spouse retains the unused Estate, Gift and GST Tax exemption amounts from a deceased spouse dying after 2010. In practice, this will allow many clients to take advantage of the increased exemption amounts without the need to transfer assets between spouses. However, the use of a "credit shelter trust" to hold the assets sheltered by the Estate and Gift Tax exemption amount at the death of the first spouse will still be a useful tool for many taxpayers because of (a) the ability to shield such assets from creditor claims and (b) the ability to transfer the trust assets, together with the growth thereon, free of Federal Estate Tax at the surviving spouse's death.

Planning Opportunities Before January 1, 2011

- The Act presents a once-in-a-lifetime opportunity for those clients who wish to make gifts to their grandchildren exceeding the new GST exemption amount of $5,000,000 (reduced by any prior use of the GST exemption). Such gifts will be subject to the low 35% Gift Tax rate *but will be free of any GST Tax,* ONLY if they are completed on or before December 31, 2010.
- In addition, distributions can be made *GST Tax free* from certain existing trusts which are not fully exempt from the GST Tax. If permitted by the trust, distributions can be made directly to grandchildren or more remote descendants free of any GST Tax, but ONLY if distributed on or before December 31, 2010.
- Finally, none of the changes in the Act affect annual exclusion gifts. To the extent clients have not already done so for 2010, they should consider making annual exclusion gifts of $13,000 per recipient.

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While personal planning should never be driven by tax goals, this major (although temporary) overhaul of the Federal Estate, Gift and GST Tax regime enhances and creates a multitude of opportunities to transfer significant wealth in a tax free or tax efficient manner. A significant increase in the lifetime Gift Tax and GST Tax exemption levels provide additional opportunities to make significant lifetime transfers to children or grandchildren, either outright or in specially designed trusts. Virtually all clients must undertake a review of their current estate plans, including titling of assets between spouses. Please contact your Private Client Group attorney to schedule an appointment to review your plan and ensure that your personal planning goals are still met, *particularly if you would like to learn more about the year-end planning opportunities discussed above.*

The members of the Private Client Group wish our readers happy holidays and a happy, prosperous and healthy new year! We look forward to hearing from you soon.

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