

New Estate, Gift and Generation-Skipping Transfer Tax Laws Benefit Virtually All U.S. Taxpayers

The Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010 (the "2010 Act"), signed into law by President Obama on December 17th, extends the so-called Bush Tax Cuts for two more years. But it also implements the most significant changes to the nation's estate, gift and generation-skipping transfer tax laws in over thirty years, and does so in a fashion that is beneficial to virtually all U.S. taxpayers and their families (at least through 2012).

Clients who are married and have wills or revocable trusts that contain tax-sensitive provisions will want to consider whether to amend their documents to take into account the possibility that they might die in 2011 or 2012 while these new rules are in effect. For a limited few, there is a short window (which closes after December 31, 2010) to make very significant gifts to grandchildren or more remote descendants at a much-reduced tax cost. The 2010 Act also confirms that estates of decedents who die in 2010 may choose not to pay estate taxes and elect instead to be subject to a regime of "carryover basis" rules.

Some of the more significant details of the 2010 Act from an estate planning perspective are summarized below.

Estate, Gift and Generation-Skipping Transfer Tax Exemptions and Rates

Under the 2010 Act, the maximum estate, gift and generation-skipping transfer (or "GST") tax rate for 2010 through 2012 is 35% (except that in 2010, the GST tax rate is 0%). During that same period, the gift, estate and GST exemptions are reunified at \$5,000,000 (except that in 2010 the gift tax exemption remains at \$1,000,000, and in 2012 the \$5,000,000 amount may be adjusted upwards for inflation). As a result, in 2011 and in

2012 married couples who previously have not made taxable gifts may combine to give away \$10,000,000 free of gift taxes.

These provisions expire in 2013. At that time (unless Congress acts again), the top gift, estate and GST tax rates will return to 55%, the gift and estate tax exemptions will return to \$1,000,000, and the GST exemption will return to roughly \$1,400,000.

Portability of Estate Tax Exemption

For the first time, the unused estate tax exemption of a married individual who dies may be transferred to the individual's surviving spouse if the executor of the deceased spouse's estate files a federal estate tax return and makes an election on the return authorizing such transfer. This new option is available for estates of married individuals who die after 2010. For example, if the first spouse dies with an estate of \$1,000,000 and does not use his remaining \$4,000,000 of estate tax exemption, his surviving spouse may use both the first spouse's \$4,000,000 of unused estate tax exemption, and her own \$5,000,000 estate tax exemption, allowing her to leave a total of \$9,000,000 to the couple's children free of estate taxes. However, the first spouse's unused gift and GST tax exemptions may not be used by the surviving spouse.

If the portability provisions of the 2010 Act are made permanent, then married couples who previously were required to divide ownership of their assets between them and to sign wills or trusts that divided assets after death between a "family trust" and a "marital trust" in order to take advantage of both of their estate tax exemptions will be able to achieve the same tax result without those

complications. Instead, the first spouse to die could simply leave all his assets to his surviving spouse, and the surviving spouse could still shield \$10,000,000 of assets from estate taxes at her later death.

Many clients may choose to simplify their estate planning documents for the reasons noted above. However, while the idea of streamlining generally is appealing, documents executed with the 2011 and 2012 rules in mind may need to be replaced after 2012 if Congress does not enact these portability provisions permanently, and in any case may not be appropriate for family reasons.

Special Estate Tax Provisions for Persons Dying in 2010

As noted above, the 2010 Act provides an estate tax exemption of \$5,000,000 and a top estate tax rate of 35% beginning in 2010 and through 2012, and continues the rules that allow the income tax basis of a decedent's assets to be "stepped up" to fair market value determined as of date of death. Thus, the "default" rule for persons dying in 2010 is that estate taxes still apply, albeit at a lower tax rate and with a higher exemption.

However, in lieu of the default rule, an estate of a decedent who dies in 2010 may elect instead to have the "carryover basis" rules apply. Under these alternative rules, the decedent's assets are not subject to estate taxes, but those assets also do not receive a "step up" in income tax basis (except to a limited extent of \$1.3 million net increase in basis and up to an additional \$3 million net increase in basis for assets passing outright to a spouse or to QTIP-like trusts for a spouse). Although each situation must be analyzed separately, it is likely that very large estates will

choose the carryover basis regime in lieu of the default rule in order to avoid paying significant estate taxes.

Generation-Skipping Transfer Tax Provisions

As noted above, beginning in 2010 and through 2012, the GST tax exemption is set at \$5,000,000 and the GST tax rate is 35%. Interestingly, however, the GST tax rate for GST transfers made in 2010 is 0%. These provisions resolve some lingering questions about the GST consequences of certain transfers made in 2010, and also create compelling planning opportunities for 2010, 2011 and 2012.

For example, gifts made in 2010 to irrevocable trusts that originally were designed to be exempt from GST tax but still benefit grandchildren or more remote descendants can be handled as they have been in the past. That is, the donor can allocate GST exemption to the gifts to maintain the trust's exempt status for GST tax purposes, and the donor will have more GST tax exemption available for such purposes. Also, gifts to irrevocable trusts for grandchildren that qualify for the \$13,000 annual exclusion from gift and GST taxes can be made in 2010

as they have in the past. In addition, in 2011 and 2012, a married couple may use their respective \$5,000,000 gift and GST exemptions to create a \$10,000,000 "dynasty" trust for their descendants that will be exempt from estate and GST taxes for as long as 360 years under current Florida law.

The GST aspects of the 2010 Act also create a very unique wealth transfer opportunity that will be available only until December 31, 2010. Extremely wealthy clients who are motivated to make significant gifts to grandchildren or more remote descendants at a reduced overall transfer tax cost can do so on or before December 31, 2010, and pay no GST taxes. For example, if a single donor makes an \$11,000,000 gift to grandchildren on December 31, 2010, and elects not to use his \$5,000,000 GST tax exemption in connection with the gift (since the GST tax rate is 0%), the gift tax cost is \$3,500,000, and no GST taxes are imposed. If that same donor waits until January of 2011 to make the same gift (when the GST rate is 35%), the GST tax liability is \$2,100,000 and the gift tax liability is \$2,835,000 (even after taking into account the \$5,000,000 gift and GST tax exemptions). Thus, the total

transfer tax cost of the same \$11,000,000 gift in 2011 is \$4,935,000.

Additional Provisions

The 2010 Act does not require grantor retained annuity trusts (or "GRATs") to have a 10-year minimum term, nor is there a prohibition on the use of discounts in valuing family-owned business entities such as limited partnerships or limited liability companies. Both limitations previously were targeted for enactment by the Obama Administration. In addition, the 2010 Act extends the time for filing qualified disclaimers of property passing by reason of the death of a decedent who dies after 2009 until nine months after the date of enactment of the new law.

From an estate planning perspective, the 2010 Act is very good news indeed, and clients may want to amend their current documents to take full advantage of this new legislation. Unfortunately, there is no guarantee that its benefits will remain in existence after 2012, which means additional changes may be forthcoming in the next two years. Careful and regular attention to these matters will be necessary and prudent.

Please contact us at your convenience and we can arrange a time to discuss how the new laws may affect you and your family.

Thomas D. Aitken taitken@trenam.com
Marla D. Bohlander mbohlander@trenam.com
Brenda Edgerton Byrne..... bbyrne@trenam.com
John R. Hixenbaugh..... jhixenbaugh@trenam.com
Richard O. Jacobs rjacobs@trenam.com
Karen E. Lewis..... klewis@trenam.com
Rachel Albritton Lunsford ... rlunsford@trenam.com

Bruce Marger bmarger@trenam.com
R. Donald Mastry rmastry@trenam.com
Harold W. Mullis, Jr. hmullis@trenam.com
D. Michael O'Leary moleary@trenam.com
Albert C. O'Neill, Jr. aoneill@trenam.com
J. Eric Taylor ttaylor@trenam.com
Don B. Weinbren..... dweinbren@trenam.com

Trenam, Kemker, Scharf, Barkin, Frye, O'Neill & Mullis

TAMPA OFFICE 101 East Kennedy Boulevard • Suite 2700 • Tampa, FL 33602 • Phone 813-223-7474
ST. PETERSBURG OFFICE 200 Central Avenue • Suite 1600 • St. Petersburg, FL 33701 • Phone 727-896-7171

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