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Re: Estate Planning In 2011 and Beyond

To our Clients, Friends, and Advisors:

In what has become an annual ritual, we are writing to inform you about the significant changes in the gift, estate, and generation skipping tax rules for 2011 and thereafter. If you think any of the changes described below affect your estate plan or are uncertain of their impact, please give us a call and we will review your documents and plan and advise you whether changes should be considered.

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("the Tax Act"). In general, the Tax Act reunified the gift, estate, and generation skipping taxes and set the exemptions at \$5,000,000 for each.

However, the Act is only effective for two years and expires at the end of 2012, at which time the tax rules revert to the provisions which existed in 2001.

The result is more uncertainty in estate planning, but some planning opportunities.

Gift Tax

Each year each person may gift \$13,000 to an unlimited number of donees with no gift tax and no gift tax return required. This is the annual exclusion gift and the \$13,000 limit remains in effect in 2011. The limit is adjusted for inflation over time and will probably remain at \$13,000 for 2012 as well.

Any gift in excess of the annual exclusion amount is a reportable gift requiring the filing of a gift tax return. However, each donor has a lifetime exemption which can be applied to reportable gifts to avoid payment of any gift tax.

In 2010 the gift tax exemption was \$1,000,000 and the Tax Act has increased that exemption to \$5,000,000 in 2011 and 2012.

Any gift in excess of the gift tax exemption will be subject to gift tax at a rate of 35%.

The Tax Act expires at the end of 2012 at which time the gift tax exemption will revert to \$1,000,000 and a gift tax rate from 41% to 55%.

The result of these rules is to provide a window of opportunity for large gifts to family members.

Estate Tax

At death the estate tax is imposed on the fair market value of the assets in the decedent's estate in excess of the estate tax exemption. The estate tax exemption is reduced by the amount of gift tax exemption used during lifetime.

The estate tax exemption has been changing every year for the past several years and was \$2,000,000 in 2008, \$3,500,000 in 2009, and unlimited for most of 2010.

The Tax Act changed the estate tax exemption to \$5,000,000 in 2011 and 2012.

Any portion of an estate in excess of the estate tax exemption will be subject to tax at the rate of 35%.

The Tax Act expires at the end of 2012, at which time the estate tax exemption will revert to \$1,000,000 and an estate tax rate from 41% to 55%.

In addition, the Tax Act created a new concept called "portability." Beginning in 2011, the unused estate tax exemption of a deceased spouse may be transferred to the surviving spouse for use when the surviving spouse subsequently dies. However, portability applies only to spouses dying after 2010 with the surviving spouse dying before 2013. Notwithstanding this new concept, we recommend that clients continue to use the By-Pass Trust in their estate plan because this will (1) avoid estate tax on the appreciation of By-Pass Trust assets, which portability does not provide, and (2) avoid estate tax on By-Pass Trust assets when portability expires in 2013.

One surprising consequence of the Tax Act relates to the computation of the estate tax in 2013 and thereafter. The current statutory language will cause an estate tax to be imposed on gifts made in 2011 and 2012 in the range of \$1,000,000 to \$5,000,000. This may or may not have been a drafting error that may be corrected by a later technical corrections act.

Generation Skipping Tax

Any transfer during lifetime or at death to a family member more than one generation below the transferor or to a non-family member more than 37-1/2 years younger than the transferor is subject not only to the gift and estate tax but also to an additional tax called the generation skipping tax.

The generation skipping tax is imposed on the portion of the transfer in excess of the generation skipping tax exemption in a manner similar to the gift and estate tax.

The Tax Act also changed the generation skipping tax exemption to \$5,000,000 for 2011 and 2012.

Any portion of a generation skipping transfer in excess of the generation skipping exemption will be taxed at a rate of 35%.

The Tax Act expires at the end of 2012, at which time the generation skipping tax exemption will revert to \$1,000,000 adjusted for inflation since 2001 and a generation skipping tax rate of 55%.

In conjunction with the higher gift tax exemption, this new rule offers a window of opportunity for (1) transfers to generation skipping trusts for children and further descendants and (2) transfers to grandchildren and further descendants, whether outright or in trust.

Carryover Basis And Adjustment To Fair Market Value

Before 2010 any property in a decedent's estate received an adjustment of its basis for income tax purposes from whatever the pre-death basis was to the fair market value at the date of death or alternate valuation date. This typically meant that pre-death appreciation disappeared for income tax purposes and was never taxed.

The repeal of the estate and generation skipping tax for the year 2010 was paid for in part by eliminating the "step up" in basis rule.

The Tax Act reinstated the step-up in basis rule for 2011 and thereafter.

However, because assets in a By-Pass Trust are not subject to estate tax on the surviving spouse's death, there is no step-up in basis for those assets at the death of the surviving spouse. Given the higher estate exemption passing to the By-Pass Trust on the death of the first spouse to die and the higher estate tax exemption on the surviving spouse's death, we may wish to revise some plans to subject part of the By-Pass Trust to estate tax on the surviving spouse's death to obtain the benefit of the step-up in basis on those By-Pass Trust assets while still avoiding any estate tax on either spouse's death.

Extension Of Charitable Distributions From IRAs


The Tax Act extended the IRA charitable rollover through 2011. An IRA owner who is age 70-1/2 or older may transfer from their IRA up to \$100,000 directly to one or more charities in 2010 and 2011 without including the distribution as income on their income tax return. Because this provision applies to every individual IRA holder, a husband and wife who both meet the minimum age requirement may transfer \$200,000 out of their IRAs to one or more charities in 2011. Because Congress acted so late in the year, individuals can complete an IRA Charitable Rollover through January 31, 2011, and still count it as a 2010 Charitable Rollover.

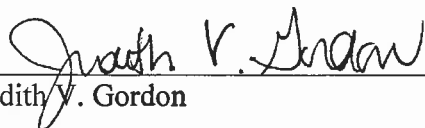
Conclusion

Since the Tax Act is very new, there may be further developments and perceived problems that are discovered in the coming months. As always, please call us if you wish to discuss the Tax Act and its implications for your estate plan.

Very truly yours,

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