

# LEGAL UPDATE

October 2010 By: Richard L. Kay, Tracy Green Landauer and Eric B. Woldenberg

## GIFTING IN 2010?—CONSIDER THE MATH

The Federal Estate and Gift Tax Laws have been much in the news this year, and for good reason. After years of increasing exemption amounts, we now have no federal estate tax, no generation-skipping transfer tax, a 35% gift tax rate and severe limitation of the step-up in tax basis for inherited property. But this year is coming to a close, and absent congressional action, we will return to:

- a **gift tax** at a rate of 55% on all but the first \$1 million of property—other than annual exclusion gifts (currently \$13,000 per recipient) and certain tuition and health care payments—transferred during the donor's lifetime to a non-spouse;
- an **estate tax** at a rate of 55% (plus an additional 5% for estates between approximately \$10 million and \$17 million) on all but the first \$1 million (less amounts used to exempt lifetime gifts from tax) of a decedent's property passing to a non-spouse;
- a **generation-skipping transfer tax** ("GST tax") at a rate of 55% on all but the first \$1,060,000 of a decedent's property passing to a grandchild or other individual belonging to a "skip" generation (less amounts transferred to such individuals during life); and
- (the good news) a **step-up in income tax basis** for inherited property to date of death value.

While it is certainly possible that Congress will act to avoid the above scenario, it seems likely that any congressional action would merely soften the blow via increased exemption amounts and lower rates, rather than by preserving this year's law. Assuming that Congress does not impose a retroactive change

in the law, individuals who expect their estates to be taxable can in many circumstances increase the net amount that will pass to their heirs by gifting before the end of 2010.

### HOW DOES GIFTING INCREASE THE NET AMOUNT RECEIVED BY HEIRS?

The projections of expected tax savings can be somewhat complicated depending upon how many variables a donor wishes to consider. But though the projections may be tricky, the principle is straightforward: passing property at a transfer tax price tag of 35% of the property's value is better than doing so at a rate of 55%. This current "bargain" transfer tax rate provides strong incentive for making gift transfers now. The benefit of a 2010 gift is greatest with outright gifts to the "skip" generation, since no GST tax applies this year.

### WHAT ACTIONS SHOULD BE CONSIDERED FOR THE REMAINDER OF 2010?

Annual exclusion gifts remain a powerful and underutilized wealth transfer tool in 2010. In addition, many planning items that did not make sense prior to this year should be re-evaluated. Options for individuals with taxable estates to consider include the following:

- Outright gifts to heirs aggregating more than the \$1 million exempt amount should be considered, especially where property that is potentially appreciating in value can be gifted (including interests in family partnerships or LLCs, and non-voting stock).
- Large cash value life insurance policies owned by the insured could be transferred out of the estate of the insured into irrevocable trusts at a 35% cost to avoid

later estate inclusion of the full policy proceeds.

- Outright gifts to grandchildren or other “skip” generation individuals can be transferred without the additional GST tax.
- Consider termination, or distribution from, non-exempt GST trusts.
- Distributions from a pre-2010 trust for a surviving spouse could be made to the spouse to facilitate gifting at a 35% rate, removing those assets from the surviving spouse’s estate.
- Consider accelerating recognition of long-term taxable gain to take advantage of the current 15% federal rate
- Consider a Roth conversion of an IRA before income tax rates are increased in 2011
- Consider additional charitable gifting, since the deduction phase-out rules are not applicable in 2010
- Create a grantor-retained annuity trust (“GRAT”) while short-term GRATs are still permitted by law.

#### **ADDITIONAL FACTORS TO CONSIDER**

##### ***Gains Tax on Future Sales of Gifted Property***

When a gift is made during the donor’s lifetime, whether in 2010 or in another year, the recipient generally receives the tax basis held by the donor. When that property is sold by the recipient, the recipient will pay gains tax on any increase in value over the original donor’s basis. Except for this year (2010), *inherited* property is treated differently. We expect that as of January 1, 2011, we will return to the previous system under which the recipient’s tax basis in inherited property is equal to the value of that property at the decedent’s date of death. This means that property passing as a result of a death will have an increased basis that reduces the gains tax due upon any subsequent sale of the property. This difference in basis should be considered in the choice of property to be gifted.

##### ***Payment of Gift Tax***

There will be a gift tax payment due on April 15th for all taxable gifts made in 2010. Donors should ensure that they have provided for the payment of this tax in making their determination of how much they choose to gift.

We strongly urge donors to work closely with their advisors to ensure that any gifts made do not have unintended consequences.

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*The foregoing is merely a discussion of the Federal Estate and Gift Tax Laws. If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact the following attorneys:*

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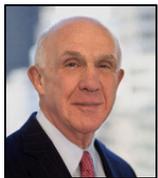
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Richard L. Kay joined Pryor Cashman in 1987 as the partner in charge of the Trusts and Estates Group and continues in that capacity. He specializes in all aspects of financial and estate planning and trust and estate administration, as well as litigation relating to will contests, disputed accounting proceedings and similar matters.

Richard has broad experience in representing a diverse client base including wealthy family groups, individuals and corporate executives and has considerable expertise representing estates and individuals with significant literary assets. He has received numerous appointments in Surrogate's Court, New York County and New York Supreme Court as Guardian ad litem.



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Tracy Green Landauer organizes and provides ongoing and special issue representation to tax-exempt organizations including arts, community, research, charitable, literary and trade organizations. She advises clients on issues of governance, unrelated business income, self-dealing, private inurement, excess benefits, foreign and domestic grant-making, complex structures, fundraising and lobbying. Tracy also provides personal estate, tax, charitable gift and retirement planning to a broad range of individuals, tailoring plans to the needs and goals of each client.

The services Tracy provides to her tax-exempt clients include:

- Counseling both new and established tax-exempt entities (including various national humanitarian research, arts and literary organizations) on issues of formation, exemption, board governance and policies, choice of entity and complex structures
- Counseling charitable organizations on:
  - Compensation planning and IRS compensation audits
  - IRS and state reporting requirements
  - Compliance issues in domestic and international grant-making
  - Unrelated business income, prohibited transactions, private inurement and operational issues
- Helping publicly supported organizations comply with state fundraising/solicitation requirements for traditional and electronic media

Tracy's services to individuals include:

- Developing comprehensive estate plans for a broad range of business owners, professionals and entrepreneurs
- Gift, estate and generation-skipping transfer tax planning
- Succession planning for business owners
- Charitable gift and income tax planning
- Developing multi-generational wealth preservation plans
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