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CLIENT NEWSLETTER

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CHANGES TO FEDERAL ESTATE, GIFT AND GENERATION-SKIPPING TRANSFER TAX LAW

By John B. West

How the Estate, Gift and Generation-Skipping Transfer Tax Laws Have Changed

As you may be aware, Congress enacted a new law at the end of last year to extend tax benefits that were set to expire after 2010. The new law, known as the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" (the "2010 Tax Law"), in addition to extending certain tax benefits, made significant changes to the Federal estate, gift and generation-skipping transfer ("GST") tax system.

This newsletter is intended to make sure you are aware of the changes and how they may impact your estate plan. In addition, the 2010 Tax Law provides some planning opportunities over the next two years of which you may want to take advantage.

Before the 2010 Tax Act, the estate tax was gradually reduced over several years and then eliminated for persons dying in 2010. Prior law provided that the estate tax would be reinstated after 2010 with a $1 million exclusion and tax rate of 55%. Other changes scheduled for years after 2010 affected the gift and GST taxes.

The 2010 Tax Act makes several changes to the estate and gift taxes, as follows:

- ***Estate tax***: The estate tax exclusion amount is increased to $5 million per person (reduced by any lifetime taxable gifts), and the estate tax rate is reduced to 35%.

- ***Gift tax***: The gift tax exclusion amount is increased to $5 million per person (or $10 million for married couples), and the gift tax rate is reduced to 35%.

- ***GST tax***: For transfers to grandchildren or lower generations, the GST tax is also increased to $5 million, and the GST tax rate is similarly reduced to 35%.

- ***Portable exemption***: Estates may elect to allow the decedent's surviving spouse to "inherit" any of the decedent's unused estate tax applicable exclusion amount. For example, if a decedent has only used $2 million of his $5 million estate tax exclusion amount, the remaining $3 million may be used by the surviving spouse.

Starting in 2013, unless Congress acts, the estate, gift and GST tax provisions that existed before 2002 will be reinstated. At the end of this newsletter is a table setting forth the new rates and exemptions for 2011, 2012 and 2013 and thereafter.[1]

Estate Planning Review Recommended

As a result of the changes in the estate, gift and GST tax laws, we recommend that your estate plan be reviewed to assess the potential implications of the new law and to determine whether any changes should be made. For example, issues to be addressed might include:

- Whether, considering the increased estate tax exemption amount, an adjustment to the amount passing on your death to your children or to your exemption trust for your spouse and/or children is warranted.

  For example, wills and living trusts commonly use a formula provision that distributes an amount of property equal to the then-existing estate tax exemption to a trust for the decedent's family or children, with the balance of property passing to the surviving spouse. The increase in the estate tax exemption to $5 million could drastically alter how your property is distributed at death, perhaps with the effect of disinheriting your surviving spouse.

- Whether, considering that your estate may not be taxable upon your death under the new law, your estate plan could be modified to give more attention to non-tax issues.

Estate Planning Opportunities

Because the recent changes to the estate, gift and GST tax laws are only in effect until December 31, 2012, we would recommend that you consider ways in which you may take advantage of estate planning opportunities, including:

- Making gifts to, or creating trusts for, children and grandchildren to take advantage of the $5 million gift and GST tax exemptions. It is possible to significantly leverage gifts of certain property to take maximum advantage of the higher exemption amounts, such as property that may have a depressed fair market value or property to which discounts may apply (ex., family limited partnership interests).

- Leveraging the increased exemption amounts through sales of assets to trusts for descendants and others.

We would welcome the opportunity to discuss these issues with you or to help you address any other estate planning questions.

[1] On February 14, 2011, the Obama Administration's Fiscal Year 2012 Revenue Proposals were released. Under the Proposals, the Administration seeks to make permanent the estate, gift and GST rates and exemptions in 2009 – that is, a $3.5 million estate tax exemption, a $1 million gift tax exemption, a $3.5 million GST tax exemption and a maximum estate, gift and GST tax rate of 45%.

The estate, gift and GST tax rates and exemptions for 2011, 2012 and 2013 forward:

	2011	2012	2013 and thereafter[2]
Estate Tax Rate	35%	35%	55%
Estate Tax Exemption	$5 million	$5 million (increased by cost of living adjustment with base year of 2010)	$1 million
Gift Tax Rate	35%	35%	55%
Gift Tax Exemption	$5 million	$5 million (increased by cost of living adjustment with base year of 2010)	$1 million
GST Tax Rate	35%	35%	55%
GST Tax Exemption	$5 million	$5 million (increased by cost of living adjustment with base year of 2010)	$1 million (increased by cost of living adjustment with base year of 1997)

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[2] These provisions will apply if Congress fails to act to undo the "sunsetting" of the Act after 2012.