



January 26, 2011

Re: Estate Planning Changes in the Law

On December 17, 2010, Congress passed and the President signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "Act"). Before the Act passed, we anticipated the return of much higher maximum rates for estate, gift and generation skipping transfer ("GST") taxes on January 1, 2011 along with lower exemption amounts. With the passage of the Act, however, there is now a two year reprieve from those higher tax rates and lower exemption amounts. The purpose of this letter is to highlight for you some of the key estate, gift and GST tax provisions of the Act and to identify planning points you may want to consider in light of the two year reprieve provided by the Act and the uncertain future of the estate, gift and GST tax rates and exemptions.

### Gift Tax Provisions

One of the most surprising aspects of the Act is its provision that in 2011 and 2012, the lifetime gift tax exemption is \$5,000,000 and the maximum rate of gift tax is 35%. Absent further legislation, the lifetime gift tax exemption will return to \$1,000,000 in 2013 and the maximum rate will jump to 55%. As a result, 2011 and 2012 provide an unprecedented opportunity for gifting.

*How does the Act affect me if I used part or all of my gift tax exemption before 2011?* Whatever amount of gift tax exemption you used prior to 2011 will reduce the \$5,000,000 available to you under the Act. For example, a person who used \$750,000 of her exemption prior to January 1, 2011, will be able to make additional gifts totaling \$4,250,000 during 2011 and 2012 free of gift tax.

*Did the Act change the annual exclusion from gift tax?* No. Each person can still make annual exclusion gifts each year to an unlimited number of donees without using any part of his lifetime gift tax exemption. The annual exclusion amount in 2011 is \$13,000.

*Who should consider making gifts in 2011 and 2012?* While the increased lifetime exemption from gift tax presents an unprecedented opportunity to transfer wealth tax free, there are a number of issues to consider before making gifts. First and foremost is whether you can afford to do so. Second is whether you are likely to have a taxable estate at death, and if so, how important it is to you to avoid or minimize this tax compared with retaining control over your assets. Other considerations include your certainty (or lack thereof) as to the persons or organizations you want to benefit from your assets.

***When should 2011 and 2012 gifts be made?*** For those clients who will make taxable gifts over the next two years to take advantage of the increased lifetime exemption, there are several key timing considerations. Once assets are gifted, any future appreciation accrues to the recipient rather than to you; this further reduces the estate tax that may be due at your death. If you believe the asset(s) you plan to gift will appreciate quickly, you will use the least amount of your lifetime gift exemption by transferring them as soon as possible. On the other hand, given the uncertain state of the estate and gift tax law going forward, there may be some wisdom in waiting until the second half of 2012 to make taxable gifts with the hope that there will be greater clarity as to post-2012 law that will allow you to make more informed decisions about the appropriateness of gifts. For example, if you plan to gift appreciated assets, your tax basis will transfer to the recipient. By contrast, if you hold the assets until death and they are included in your taxable estate, the recipient receives them with a basis equal to their fair market value at your death. As a result, if further legislation passes that keeps the estate tax exemption amount at \$5,000,000 or more on a permanent basis, you may be better off holding certain assets until death rather than gifting them during life.

***What form should my lifetime gifts take?*** If you decide to take advantage of the higher gift tax exemption amount in 2011 or 2012 by making lifetime gifts, you should consider the most effective use of your exemption. This might involve using a grantor retained annuity trust (GRAT), qualified personal residence trust (QPRT) or making a seed gift so your beneficiary can purchase assets from you.

### **Estate Tax Provisions**

For 2011 and 2012, the Act “unified” the gift and estate tax exemptions and rates. This means that the estate tax exemption for individuals who die during this time is \$5,000,000, less the amount of lifetime taxable gifts made. Transfers in excess of this exemption amount will be subject to estate tax at a maximum rate of 35%.

***Is the estate tax exemption amount in addition to the gift tax exemption amount?*** No, during 2011 and 2012, each person may transfer up to \$5,000,000 free of gift and estate tax on a combined basis either during lifetime and/or at death. If a person makes \$3,000,000 of lifetime gifts, she will be able to make an additional \$2,000,000 of transfers free of estate tax at death.

***I have heard that a key feature of the Act was portability of my unused estate tax exemption amount to my surviving spouse. How does this work?*** The Act provides that the executor of a person who dies in 2011 or 2012 can file an estate tax return and elect to transfer (or “port”) the deceased spouse’s unused estate tax exemption amount to his or her surviving spouse. Unless the Act is extended, however, the ability of the surviving spouse to use this additional exemption will disappear at the end of 2012. The Act also does not permit the transfer of unused

exemption from a spouse who died prior to 2011. The portability provisions of the Act are fairly complex, and given their short term application, we generally do not recommend that you plan your estate with the expectation that you will be able to take advantage of them. If, however, you lose a spouse in 2011 or 2012, it will be important for you to discuss with us how these portability provisions apply to your situation as related planning opportunities may arise.

*What happens if I use my entire lifetime gift exemption in 2011 or 2012 and then at my death the estate tax exemption amount is less than \$5,000,000? We do not have complete clarity on this point, though we can be sure that you would not have any remaining exemption to use at death. This would mean that all of your remaining assets at death would be subject to estate tax.*

### **Generation Skipping Transfer Tax Provisions**

The Act provides for a GST tax rate of 35% on gifts from individuals to “skip-persons” who are two or more generations younger than the donor (e.g. grandchildren or other people more than 37 ½ years younger than you are). This same tax is also imposed upon distributions from trusts to skip-persons unless the trusts are exempt from GST tax. The GST exemption is \$5,000,000 in 2011 and will be \$5,000,000 plus an inflation adjustment in 2012.

By reason of the Act’s generous GST tax provisions, 2011 and 2012 will be ideal years to establish trusts for future generations of your family.

### **Next Steps**

Because the Act contains a significantly higher exemption from estate tax than has previously existed, you should review your estate plan to ensure that it still accomplishes your goals. For example, if your plan includes a gift to someone of the maximum amount that can be transferred free of estate tax, this gift may be much more significant than you originally anticipated. On the other hand, what remains after such a gift is made may be less than originally anticipated, resulting in fewer assets going to your residuary beneficiaries. You should also review your assets and plan to determine if it makes sense for you to take advantage of increased lifetime gift opportunities under the Act.

For the last several years we have been planning amidst a great deal of uncertainty and had hoped that the Act would bring clarity and permanence to estate and gift tax planning. While this unfortunately did not happen, the Act does open up new planning opportunities during the next two years. If you would like us to review your plan and discuss with you planning considerations in light of the Act, please call us. As always, we recommend you review your plan anytime you experience a major life change (birth, death, marriage, divorce), desire to update your beneficiary or

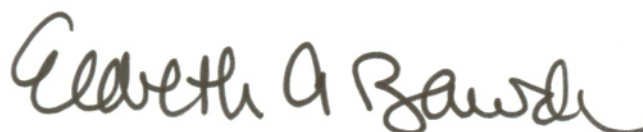
fiduciary designations, and otherwise every 3-5 years. We appreciate the opportunity to be of assistance to you.

Very truly yours,

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P.S. If you had a family member pass away during 2010 and are already working with us to administer their affairs, we will discuss the impact of the Act on this administration with you separately. If we are not already advising you in connection with the affairs of a family member who passed away in 2010, please feel free to call us if you would like to understand the implications of the Act as they affect your situation.

Table Summarizing Rates and Exemptions

	2009		2010		2011 & 2012		2013 <sup>2</sup>	
Tax	Exemption	Rate	Exemption	Rate	Exemption	Rate	Exemption	Rate
Gift	\$1M	45%	\$1M	35%	\$5M	35%	\$1M	55%
Estate	\$3.5M	45%	\$5M	35% <sup>1</sup>	\$5M	35%	\$1M	55%
GST	\$3.5M	45%	\$5M	0%	\$5M	35%	\$1M	55%

<sup>1</sup> Estates of those who died in 2010 have the option to elect out of the estate tax and instead proceed under a modified carryover basis regime.

<sup>2</sup> 2013 exemptions and rates are subject to further Congressional action and the GST exemption will be indexed for inflation.