

## Estate and Gift Tax Alert

### Estate Planning Opportunities for 2011 and 2012

January 6, 2011

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In December 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Authorization and Job Creation Act of 2010 (TRA 2010). Among other provisions, TRA 2010 finally addressed uncertainties in the federal estate, gift and generation-skipping transfer (GST) tax laws, although only with respect to estate and gift transfers during the period beginning January 1, 2011, and ending December 31, 2012. TRA 2010 has created new opportunities and incentives to transfer wealth to heirs in 2011 and 2012. Some of the most important provisions of TRA 2010—and

#### Increase in Federal Transfer Tax Exemptions, Reunification of Federal Estate and Gift Taxes and Decrease in Transfer Tax Rates

- Under TRA 2010, for estate and gift transfers in 2011 and 2012, the estate and GST tax exemptions available to an individual increase to \$5 million. Moreover, the estate and gift taxes have been “reunified” for 2011 and 2012 (as they were prior to 2001), so that the total lifetime gift tax exemption available to an individual also increases to \$5 million. As under the law prior to TRA 2010, (i) the gift or GST tax exemption available to an individual with respect to lifetime gifts will be reduced by the amount of the relevant exemption such individual used prior to 2011; (ii) the estate tax exemption available at the individual’s death will be reduced by the amount of gift tax exemption such individual used during his or her lifetime; and (iii) the GST tax exemption available at the individual’s death will be reduced by the amount of GST tax exemption such individual used during his or her lifetime.
- Also under TRA 2010, the top federal estate and gift tax rates applicable to estates of individuals dying, and to taxable gifts made, in 2011 or 2012 decrease to 35 percent. The GST tax rate applicable in 2011 and 2012 is a flat rate equal to 35 percent, generally imposed on all gifts made to, or in trust for, or from trusts to, grandchildren, with certain exceptions.

#### Portability of Estate Tax Exemption Between Spouses

- Another significant and brand-new change under TRA 2010 is that estate tax exemptions will be “portable” between husband and wife. This means that if the estate of the first spouse to die is, for any reason, unable to use the entire amount of the deceased spouse’s remaining estate tax exemption, the executor of the deceased spouse’s estate may elect to transfer any “unused” estate tax exemption to the surviving spouse. The surviving spouse, in turn, may use the transferred exemption in connection with his or her own lifetime gifts and/or to offset estate taxes imposed at the surviving spouse’s death. Of course, this benefit will be effective only if the surviving spouse makes taxable gifts or dies in 2011 or 2012.

#### Make Substantial Gifts

- The combination of the increased gift tax exemption and decreased gift tax rates make gifting, including gifting to grandchildren, more attractive than ever in 2011 and 2012.
  - The \$5 million gift tax exemption will allow you to make substantial taxable gifts and take advantage of certain estate planning techniques during this two-year period without actually having to pay any gift tax.



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- Making current gifts that use up your gift tax exemption removes from your estate not only the gifted property, but also any future income or appreciation related to that property, thereby reducing your future estate tax exposure and benefiting your heirs that much sooner.
  - If you make current gifts that exceed your available gift tax exemption and incur gift tax, and you survive for three years after making the gift, the amount of the gift tax (and the appreciation thereon) will also be removed from your estate.
  - In addition to reducing the size of your estate, paying gift tax now<sup>1</sup> may be advantageous because gift tax is imposed in a more favorable way than estate tax. Gift tax is imposed on a tax-exclusive basis, i.e., only on the net amount of the gift the donees receive. Estate tax, on the other hand, is imposed on a tax-inclusive basis, i.e., on all of the estate's assets, including the assets that will be used to pay taxes, leaving less for your heirs.
  - The possibility remains that these favorable transfer tax exemptions and rates may be repealed, in whole or in part, or otherwise negatively affected by future tax legislation.
- For all of the above reasons, taking advantage of this two-year window of opportunity by making gifts in 2011 and 2012 up to the maximum amount of your available gift tax exemption—and even paying gift tax now at the low 35 percent rate—may result in your heirs receiving significantly more than they would receive from your estate by reason of your death in these or future years.

## Continue to Create GRATs

- In previous alerts, we highlighted various proposals that would have limited the utility of Grantor Retained Annuity Trusts (GRATs) by requiring (i) a GRAT to have a minimum term of 10 years and (ii) a GRAT's remainder interest to have a value greater than zero, requiring the grantor to make a taxable gift. None of these proposals is included in TRA 2010, so GRATs remain a viable, tax-effective estate planning option.
- The IRS imputed interest rate continues to be quite low—2.4 percent for a transfer to a GRAT in January 2011—increasing the likelihood that investment performance will exceed the imputed interest rate and the GRAT will be successful. You should consider the potential impact of increasing interest rates on GRAT planning in the near future, including whether it might make sense to create a longer-term GRAT now to “freeze” today's lower interest rates for a longer period.

Given the new developments in the estate, gift and GST tax laws, we believe this is a logical and important time to review your estate planning and consider the effects of the rules that will be in effect for 2011 and 2012, as well as possible future changes to those rules. It is also an opportune time to consider and possibly take advantage of some valuable estate planning techniques that may not be as favorable in the future. Of course, before engaging in any estate planning, you should consult with your Akin Gump Strauss Hauer & Feld LLP advisor to determine whether and to what extent taking advantage of the changes in the tax law by lifetime and testamentary planning at this time makes sense for you and your family, as well as to identify the optimum manner in which to structure and implement your planning.

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<sup>1</sup> Gift tax imposed on any gifts made in 2011 will be due on April 15, 2012; in the case of 2012 gifts, the gift tax will be due on April 15, 2013.