Tax Relief, Unemployment Insurance Re-Authorization and Job Creation Act of 2010
Generation Skipping Transfer-Tax Issues
Estate and Gift Tax Planning

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Generation Skipping Transfer Tax (GST-Tax)

- Overview
  - GST-Tax Rate
    - 2010: zero
    - 2011 and 2012: 35%
    - 2013 forward: 55%
  - GST-Exemption
    - 2010-2012: $5,000,000
    - Beginning in 2012 the GST-Exemption is indexed for inflation
    - Unless changed by legislation exemption in 2013 and future years will be $1,000,000, indexed for inflation from 1997
    - Not portable (unlike gift and estate tax exemptions)

Generation Skipping Transfer Tax (GST-Tax)

- 2010 Lifetime Transfers
  - Gifts to skip persons are subject to the GST-Tax, but taxed at a rate of 0%
  - Gift to “Skip Trusts” made in 2010 will not be subject to the GST-Tax when distributions are ultimately made to grandchildren
    - Move Down Rule of IRC Section 2653 applies to “Skip Trusts” created in 2010
    - Distribution from a “Skip Trust” to more remote descendant than a grandchild in future years may result in GST-Tax if GST-Exemption is not allocated to contribution
      - Exception for payment of medical and education expenses

Generation Skipping Transfer Tax (GST-Tax)

- 2010 Lifetime Transfers (cont.)
  - Transfers to trusts do not automatically result in a zero inclusion ratio. Must allocate GST-Exemption to ensure zero inclusion rate
    - 2010 contributions to trusts are not "grandfathered from the GST-Tax"
    - Contributions to life insurance trusts, family trusts, etc.
  - Gift must occur in 2010 to qualify for zero percent rate
  - Consider opting-out of the automatic allocation rules for direct skips passing to current beneficiary

Generation Skipping Transfer Tax (GST-Tax)

- Allocation of GST-Exemption
  - Clients have an additional amount of GST-Exemption to allocate to 2010 and prior gifts
  - Allocation of GST-Exemption to 2010 gifts
    - Timely allocation: use gift tax values for purposes of determining amount of GST-Exemption to allocate
    - Late Allocation: gift tax return can be filed no earlier than April 19, 2011. Use value of assets as of effective date of allocation (1st day of month gift tax return is filed)

Generation Skipping Transfer Tax (GST-Tax)

- Late Allocation of GST-Exemption to Pre-2010 Transfers
  - Increased exemption gives clients the opportunity to allocate additional GST-Tax exemption to prior trust contributions at current values
  - Given possibility that $5,000,000 GST-Exemption can sunset in 2013, encourage clients to utilize increased exemption while it is available
    - Must consider practical impact of automatic allocation rules for GST-Exemption has had on client's available exemption

Estate and Gift Tax Planning Issues

- Drafting Estate Planning Documents
  - Effect of Increased Exemption
    - Clients may prefer simplicity
    - Is it wise to rely on portability of estate and gift tax exemption in drafting estate plan?
      - Will portability apply after 2012?
      - Deceased spouse's unused exemption is not indexed for inflation
      - State estate tax exemptions are not currently portable
      - GST-Tax Exemption is not portable
      - Only last deceased spouse's unused exemption qualifies for portability
      - What if federal estate tax exemption declines in the future?
    - Non-tax reasons to create Estate Tax Sheltered Trust under estate plan
      - Future growth not included in survivor's estate
      - Creditor protection
      - Control ultimate disposition of assets

Estate and Gift Tax Planning Issues

- State Estate Tax Issues
  - Many states (including Connecticut, New York, Rhode Island, Massachusetts, Maine and Vermont) have estate tax exemptions well below the $5,000,0000 federal exemption
    - Consider use of "QTIPable" Estate Tax Sheltered Trust
  - Increased exemption may result in large state estate tax liability at first spouse's death
  - State only QTIP Election
    - Rhode Island and Massachusetts permit separate QTIP election

Estate and Gift Tax Planning Issues

- Maine QTIP limited to $2,500,000. Not clear if this limitation will be increased for 2011 and future years
- New York QTIP election available when no federal estate tax return is required (2010) or when value of gross estate is below the federal filing threshold
  - What approach do you take for NY decedent with over $5,000,000
- Connecticut QTIP
  - Connecticut QTIP must be equal to federal QTIP election (based on Department of Revenue's interpretation of statute)
  - If estate planning documents contain typical residuary distribution to Estate Tax Sheltered Trust/Marital Trust, may have Connecticut estate tax due at first spouse's death
  - Consider use of outright marital bequest where appropriate to reduce likelihood of Connecticut estate tax at first spouse's death

Estate and Gift Tax Planning Issues

- Formula Clauses
  - 2010 Act covers 2011 and 2012, then what?
  - Will there be a repeat of 2010 where there was a great deal of uncertainty regarding meaning to be given to terms contained in estate planning documents and how assets would pass
  - Must review estate plans which leave "maximum amount that can pass free of federal estate tax" or amount based on "unified credit" to non-spouse beneficiaries
  - Does uncertainty create a need for a more "personalized approach" to the estate plan?

Estate and Gift Tax Planning Issues

- Gifting
  - Federal Gift Tax Exemption is $5,000,000 for 2011 and 2012
    - Additional $4,000,000 of federal exemption
    - May make taxable gifts of $4,000,000 even if previously made taxable gifts in excess of $1,000,000
    - Federal Gift Tax Exemption is portable
      - When making taxable gift, does donor spouse use her gift tax exemption, or deceased's spouse's unused exemption
        - » Language in Joint Committee's technical explanation that for estate tax, use deceased spouse's unused exemption. Not certain same analysis would apply for gift tax

Estate and Gift Tax Planning Issues

  - Surviving spouse should consider using unused exemption sooner rather than later in the event federal gift tax exemption decreases or surviving spouse remarries
- Must be concerned about "claw back" issue
  - General belief that "claw back" will not occur, but should advise client of potential risk
- How comfortable will clients be in gifting such significant amounts?
- Connecticut Gift Tax Exemption: $3,500,000 for post-2004 taxable gifts

Estate and Gift Tax Planning Issues

- Benefits of Lifetime Gifts
  - Remove future appreciation from donor's estate
  - Gifts to grantor trust– under current law payment of income taxes by donor reduces donor's gross estate
  - If donor survives three (3) years from the date of the gift, federal gift tax excluded from gross estate
    - Query: In these uncertain times, do you advise a client to pay a federal gift tax?

Estate and Gift Tax Planning Issues

- Gifting Techniques
  - Outright gifts
  - Gifts of interest in Family Partnership/Family LLC
    - Act did not change ability to use family partnerships to transfer wealth to descendants
  - Grantor Retained Annuity Trust
    - Act does not require minimum term or minimum remainder interest
  - Gifts and sales to grantor trust
    - Sale to intentionally defective grantor trust v. GRAT
  - Qualified Personal Residence Trusts
    - Higher gift tax exemption and lower real estate values may make this an ideal time to consider creation of QPRT notwithstanding low interest rate environment
    - Consider utilizing QPRT to transfer real estate in state which does not impose a gift tax, but does have an estate tax (i.e. Massachusetts, New York, Rhode Island, Vermont, Maine)

Estate and Gift Tax Planning Issues

- Life Insurance Trusts
  - Consider substantial gift to Insurance Trust to fund new policy or payment of future premium payments
- Dynasty Trusts
  - Must create trust in jurisdiction which does not have Rule Against Perpetuities (Examples: Delaware, New Hampshire, Rhode Island)
  - Increased GST-Tax Exemption makes Dynasty Trusts more appealing
- Lifetime Estate Tax Sheltered Trust for spouse
  - May provide more flexibility in drafting. Create trust for spouse and descendants, income and principal available as needed for health, education, reasonable comfort and support
  - Spouse can be given special power of appointment. Include donor spouse as eligible appointee? Trust for his/her benefit?
  - Draft as Grantor Trust
- Reciprocal "Flex Trust"
  - Each spouse creates trust for benefit of spouse and descendants
  - Must alter terms of trusts to avoid application of reciprocal trust doctrine
  - Flexibly draft document to permit return of principal to spouse if needed

Estate and Gift Tax Planning Issues

- Self Settled Discretionary Trusts
  - Trust would allow for discretionary distribution to Settlor in discretion of an Independent Trustee and trust corpus must not be subject to claims of Settlor's creditors
  - Twelve states (Alaska, Delaware, Hawaii, Missouri, Nevada, New Hampshire, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah and Wyoming) have enacted "Self-Settled Spendthrift Trust" legislation
  - Only Alaska and Nevada bar all creditors. Remaining states allow some creditors to reach trust assets
    - Example: Child support and/or alimony payments