

January 2011 Estate and Gift Tax Newsletter

The recent passage of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (“the Act”) permeates virtually all socioeconomic classes of the American population. Given the Act creates an opportunity for the next two years, clients and their advisors should discuss how the legislation impacts them and what, if any planning they should implement as a result. A prudent strategy should address income tax planning and incorporate wealth transfer opportunities in coordination with clients’ estate plans. While the Act is far-reaching, we have sought to summarize the key provisions relevant to our clients.

GIFT AND ESTATE TAX PLANNING

Gift Tax

In addition to the \$13,000 per donee exclusion - the size of gifts a taxpayer may make to as many individuals as he or she wishes each year - a client may use his lifetime gift exemption to make up to an additional \$5,000,000 in tax-free gifts, an increase of \$4,000,000 from the prior \$1,000,000 lifetime exemption.

Planning Idea (lifetime gift): For a client who has already utilized his \$1,000,000 lifetime exemption, he should consider using a portion of the remaining \$4,000,000 to make a gift outright or in trust. If Bill, a 55 year old, makes an additional \$1,000,000 tax-free gift to a trust for his children which grows at 7% annually, Bill will have shifted over \$6,000,000 in future appreciation out of his estate by Bill’s age 85, creating an estate tax savings of approximately \$2.3MM for his children. Moreover, if Bill makes that \$1,000,000 gift to an irrevocable life insurance trust, the Trustee could purchase a single premium life insurance policy with a permanent death benefit of \$7,199,682¹, which would pass to Bill’s children or grandchildren completely free of income taxes, estate taxes or GST taxes.

Planning Idea (asset protection): As an asset protection strategy, clients could use a portion of the increased lifetime exemption to gift a residence or other property in trust. After five years have elapsed, then the home of a Massachusetts resident would be insulated from the costs of long-term care and/or creditors.

Planning Idea (loan forgiveness or new intra-family loans): Applicable Federal Rates – the minimum interest rate blessed by the IRS that individuals may charge one another without the loan being considered a gift – are historically low as of January, 2011: 0.43% for short-term, 1.95% for mid term and 3.88% for long-term loans. This presents two opportunities. The first is for a wealthy client to provide an intra-family loan to a child, for a mortgage or otherwise, so the child can borrow at 3.88% rather than institutional lending rates. Second, if a client has already loaned money to a family member, or implemented an *Installment Sale to a Grantor Trust*,

¹Assumes preferred plus non-smoker, 44 year old male, Massachusetts resident; quote provided by John Hancock Life Insurance; actual rates may be higher or lower than illustrated and are subject to medical and financial underwriting.

the client might consider forgiving the loan, which would constitute a gift; because of the increased lifetime exemption, the forgiveness of the loan could be gift-tax free.

Estate Tax

The estate tax now applies retroactively to the estate of individuals dying in 2010, with an exemption of \$5.0MM and a 35% rate on amounts that exceed this, but [the personal representative of] wealthy clients may wish to elect the alternative option: to have modified basis rules apply such that capital gains taxes, but not federal estate taxes, apply to the estate.

For individuals dying in 2011-12, the amount that can be passed free of federal estate taxes to beneficiaries is \$5.0MM, a marked increase from \$3.5MM available in 2009. While some clients may perceive this as a reason not to worry about estate taxes, beware: Massachusetts and most other states impose a separate estate tax, and the increase is only scheduled to last through the end of 2012, reason enough to continue planning.

Generation-Skipping Transfer (“GST”) Tax

Transfers subject to GST tax, for example a transfer to a grandchild, are subject to a flat 35% rate.

Planning Idea: Given the mounting deficit, strain on the Social Security and Medicare programs, and the pattern of the government spending that which it cannot afford based on current revenues, this attorney’s opinion is that the income and/or estate taxes will rise in 2012+. The economy, locally and nationally, cannot support the municipal infrastructure, social programs and defense budget without increased revenue, be it through income taxes, estate taxes, GST taxes or other means. If history is any guide, our government will turn to high-income taxpayers to shoulder a disproportionate share of the economic burden (“responsibility”). Thus it is highly likely that Generation-Skipping Transfers, an oft-employed strategy of the wealthy, will not continue to receive the luxury of favorably low, 35% tax treatment. Clients should consider transfers now at a 35% rate rather than subject that wealth – and its future appreciation – to potentially higher rates in years to come.

Portability

The executor of a decedent dying after December 31, 2010 can elect to provide his surviving spouse with the unused portion of his “exclusion amount”. To do so, the deceased spouse’s executor must file a timely estate tax return indicating the unused amount and elect to make it available to the surviving spouse. Portability between spouses does not apply to the GST tax exemption.

Planning Idea: Clients and advisors should review: a) their trusts; and b) how their assets are titled. If portability becomes the “new normal”, clients might consider holding assets in a joint trust, dispensing with the need to “equalize” estate (keeping ½ of the combined estate in each spouse’s name) to maximize wealth transfer.

INCOME TAX PLANNING

Income Tax

The reduced income tax rates under the Economic Growth and Tax Relief Reconciliation Act of 2001, also known as “EGTRRA”, have been extended through 2012. While all taxpayers would have paid an average of 2-3% higher income taxes had the bill not been passed by the Senate and the House, high income earners arguably would have been impacted most significantly, with the top rate rising from 35% to 39.6%.

Social Security Tax Cut

All taxpayers will reap the benefit of a temporarily-reduced social security payroll tax, from 6.2% to 4.2% for individuals, and from 12.4% to 10.4% for self-employed individuals.

Itemized Deductions

Repeal of the personal exemption phase-out and itemized deduction limitation has been extended for an additional two years. The effect on high-income earners is a continued respite from a reduction in allowable deductions.

Capital Gains and Dividend Rates

A favorable capital gains rate - 15% for those in the 25%+ income tax bracket - is extended. Such taxpayers would have faced higher capital gains rates and ordinary income tax rates on dividends had legislation not been passed.

AMT

Exemption amounts are increased to \$47,450 (\$72,450 if married filing jointly) for 2010 and \$48,450 (\$74,450 if mfj) for 2011.

IRA Charitable Rollover

Individuals who are 70.5 or older may transfer up to \$100,000 annually to a qualified public charity without the transfer being treated as a taxable withdrawal. Furthermore, the transfer can be counted towards taxpayer's Required Minimum Distribution.

As always, it is our job to identify opportunities for your family's benefit as well as keep you apprised of topical legal, tax, and financial developments. Feel welcome to call if you have questions or would like to schedule a conference call with us and your other investment professionals.

Regards,

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