

Client Alert

PRIVATE CLIENT SERVICES DEPARTMENT | DECEMBER 2010

WIGGIN AND DANA
Counsellors at Law

2010 Year-End Planning Opportunities

Now that we can feel reasonably confident that Congress will not reinstate the estate and generation skipping transfer tax laws retroactively, we believe that 2010 affords unique estate planning opportunities which may not be available in 2011.

BACKGROUND

For 2010 the federal estate and generation skipping transfer (GST) taxes were repealed in their entirety. If Congress does not extend the estate, gift and GST tax provisions of the Bush-era tax cuts, on January 1, 2011 these taxes will revert to the provisions in effect in 2001, with a 55% rate and a \$1,000,000 exemption¹. The federal gift tax was not repealed. Instead, for 2010 the federal gift tax rate decreased to 35% and the exemption remained at \$1,000,000. Without legislative action, the gift tax rate will rise back to 55% in January.

TAXABLE GIFTS

The gift tax rate in 2010 is 35% and it is expected to rise to 55% in 2011. If you have exhausted your lifetime gift tax exemption of \$1,000,000, paying tax on gifts can be more advantageous than paying estate tax on the same property. This is because the gift tax is imposed on a "tax exclusive" basis, while

the estate tax is imposed on a "tax inclusive" basis. Put simply, the funds used to pay the estate tax are taxed in a decedent's gross estate, but the funds used to pay the gift tax are not included in the tax liability. For example, compare an individual who makes a lifetime taxable gift of \$1,000,000 in 2010 versus an individual who makes a bequest at death of \$1,000,000 in 2011. The family of the person making the taxable gift in 2010 can save over \$872,000 in taxes² as illustrated in the chart below:

The analysis above assumes that the 35% gift tax rate is not retroactively repealed and replaced by a higher rate by Congress. While retroactive repeal of the 35% rate seems a remote possibility, clients considering making taxable gifts in 2010 should consult with their Wiggin and Dana attorney about methods for minimizing the risks associated with a possible retroactive repeal.

GIFTS TO GRANDCHILDREN

Ordinarily a gift to a grandchild results not only in a gift tax but also in a separate GST tax. As noted above, however, for 2010 only the GST tax is repealed. Accordingly, a gift to a grandchild should magnify the benefits of making a taxable gift in 2010

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	Lifetime Gift of \$1,000,000 in 2010	Bequest at Death of \$1,000,000 in 2011
Tax Rate	35%	55%
Gift or Estate Tax	\$350,000	\$1,222,000
Total funds needed to transfer a net \$1,000,000 to the recipient	\$1,350,000	\$2,222,000

¹ The GST tax exemption in 2011 will actually be greater than \$1,000,000, as the figures is adjusted for inflation. As of the printing of this Alert, the precise figure has not been released by the federal government.

² To achieve the full tax savings, the donor must live for more than 3 years after making the gift.

**PRIVATE CLIENT SERVICES
DEPARTMENT CONTACTS**

LEONARD LEADER, *Chair*
203.363.7602
lleader@wiggin.com

ROBERT W. BENJAMIN
212.551.2602
rbenjamin@wiggin.com

ELISABETH H. CAVANAGH
203.363.7637
ecavanagh@wiggin.com

MICHAEL T. CLEAR
203.363.7675
mclear@wiggin.com

KAREN L. CLUTE
203.498.4349
kclute@wiggin.com

DANIEL L. DANIELS
203.363.7665
ddaniels@wiggin.com

FALLON DEPINA
203.498.4303
fdepina@wiggin.com

MARK E. HARANZO
203.363.7640
mharanzo@wiggin.com

HELEN C. HEINTZ
203.363.7607
hheintz@wiggin.com

ARSINEH KAZAZIAN
212.551.2632
akazazian@wiggin.com

DAVID W. KESNER
203.498.4406
dkesner@wiggin.com

CHARLES C. KINGSLEY
203.498.4307
ckingsley@wiggin.com

DAVID T. LEIBELL
203.363.7623
dleibell@wiggin.com

since the gifted property is removed from the transfer tax system for two generations rather than only one. However, because of certain technical provisions of the law, it appears that only gifts made outright to grandchildren will achieve the additional GST tax savings. A gift in trust, or even a gift to an UGMA or UTMA account for a grandchild, may not safely avoid GST tax in future years. Clients considering gifts, and especially gifts to trusts, in 2010, should consult with their Wiggin and Dana attorney **before** making any such gift.

TRUST DISTRIBUTIONS

Distributions from trusts that are not exempt from GST tax may be made to “skip” persons (usually grandchildren or great-grandchildren of the individual who created the trust) in 2010 without the imposition of GST tax. This law is only in effect in 2010 and, come 2011, distributions to “skip” persons will incur a GST tax. If you are the trustee or the beneficiary of a trust that is not exempt from GST tax, the pro’s and con’s of a distribution from the trust to a skip person or persons should be carefully considered before the end of this year.

GRATs

A Grantor Retained Annuity Trust, or GRAT, has been a useful and reliable tool for removing significant wealth from an individual’s estate at a low gift-tax cost. In a typical GRAT, you transfer property to a trust, receiving back an annuity payment for a fixed term. At the end of the term, the remaining trust property passes to your children or other family members gift tax free. The taxable gift is measured as the total value of the property placed in the trust minus the discounted present value of the retained annuity. The discounted present value of the retained annuity is calculated using the Applicable Federal Rate (AFR), as set monthly by the IRS.

Over the course of the past year, several proposals have been introduced in Congress that would significantly limit the availability of the GRAT technique. While the law has not yet changed, clients considering a GRAT should be aware of the possible legislative threat and may wish to act immediately to establish a GRAT before any change in the law. In addition, the December 2010 AFR is 1.8%, which is a historically low rate. If you are considering a GRAT, or if you have concerns about your existing GRAT, now is the time to act.

INTRA-FAMILY LOANS

Loans among family members must carry a minimum interest rate to avoid being recast as gifts. The interest rate is set by the IRS and is 0.32% for a short-term loan (less than 3 years)³; far less than the rates charged for most commercial loans. Clients should consider loans to get principal into the hands of beneficiaries, who can invest the money and earn a rate of return which is higher than the interest rate charged on the loan. The interest rate differential represents an opportunity to create a tax free shifting of wealth to younger generation family members.

TALK TO US

It is impossible to predict precisely how Congress will address the expiring estate tax repeal. However, if Congress does not act and the laws scheduled to come into existence in 2011 apply to your estate, you may miss a planning opportunity. We recognize that this can be a challenging and even confusing time for our clients in thinking about their estate planning. Please don’t hesitate to contact any of the lawyers in Wiggin and Dana’s Private Client Services Department with questions about this Alert or any planning issue.

³ Rate for loans made in December, 2010.