

THE NEW ESTATE & GIFT TAX LAWS

“The 2-Year Window of Opportunity”

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PAUL A. GONTAREK is a partner with Howard & Mobley, PLLC and concentrates his practice in the area of trust and estate litigation. His practice includes the representation of banks, fiduciary institutions, families, individuals, charities and other entities in will contests; breach of fiduciary duty lawsuits; court actions to clarify, interpret or refine specific provisions of wills and trusts; requests to the court on behalf of trustees for instruction and direction; and litigation to settle distributive rights to beneficiaries. For the past three years, Paul has served as the Chair of the Probate Court Committee for the Nashville Bar Association and is also a member of the Editorial Board of the Tennessee Bar Journal.

THE HEADLINES

\$5 million applicable exclusion amount.

35% rate for estate & gift tax.

Unification of Estate & Gift taxes.

Portability of applicable exclusion amount for married persons.

Full Step-Up in Basis at Death.

\$5 million GST Exemption & 35% GST tax rate.

Capital Gain income tax rate stays at 15%.

2010 decedents can elect carryover basis and no estate tax.

New Act *sunset*s on December 31, 2012.

BEHIND THE HEADLINES: \$5 million applicable exclusion amount

For decedents dying in 2011, the applicable exclusion amount is \$5 million.

For decedents dying in 2012, the \$5 million applicable exclusion amount will be indexed for inflation.

For decedents dying in 2013 and beyond, the applicable exclusion amount reverts to \$1 million, *unless Congress*

BEHIND THE HEADLINES: 35% rate for estate & gift tax

For 2011 & 2012, the federal estate tax rate is 35%.

For 2011 & 2012, the federal gift tax rate is 35%.

The advantages of making lifetime taxable gifts over taxable transfers at death still holds true.

For 2013 and beyond, the pre-2001 rates return—55%, *unless Congress*

BEHIND THE HEADLINES: Unification of Estate & Gift Taxes

In 2011-12, the estate and gift tax exclusion amounts are the same—they are “unified.”

You can give away the entire applicable exclusion amount (\$5 million) free of federal gift tax.

Compare with prior years when estate and gift tax exclusions weren't unified. For example, in 2009 you could only give away \$1 million free of gift tax even though the estate tax exclusion was \$3.5 million.

Tennessee still has its gift tax. If you make a \$5 million gift in 2011-12 you pay no federal gift tax but you pay Tennessee gift tax of \$463,400.

BEHIND THE HEADLINES: Portability of applicable exclusion amount for married persons

For 2011-12, the unused estate tax exemption of the first spouse to die can be added to the estate tax exemption of the surviving spouse.

For example, husband dies in 2011 with \$10 million net worth: \$5 million in IRA and life insurance payable to wife, and \$5 million of jointly owned assets with wife. If wife dies in 2012 she'll have a \$10 million estate tax exemption. (Her \$5 million exemption plus her husband's unused exemption of \$5 million.)

To take advantage of portability, a federal estate tax return MUST be filed at death of first (predeceasing) spouse.

BEHIND THE HEADLINES: Portability of applicable exclusion amount for married persons (cont.)

We view “portability” as more of a trap than an opportunity.

Both spouses must die in 2011-2012 to take advantage of portability, *unless Congress*

Surviving spouse receives unused exemption of “*last deceased spouse.*” If surviving spouse remarries they lose portability with respect to first spouse’s unused exemption.

Establishment of traditional Bypass/Credit Shelter Trust at death of first spouse is still recommended.

- * Assures utilization of \$5 million exemption.**
- * Protects assets from remarriage/elective share concerns and creditors during surviving spouse’s life.**
- * Keeps asset growth/appreciation on exemption amount out of surviving spouse’s estate.**

BEHIND THE HEADLINES: Full Step-Up in Basis at Death

For decedents dying in 2011-12, all assets in taxable estate receive a full step-up in basis at death.

For decedents dying in 2013 and beyond, full step-up in basis at death remains intact.

For 2010 decedents, you can elect to have either full step-up in basis or to have the modified carryover basis rules that accompanied the 2010 year of estate tax repeal.

BEHIND THE HEADLINES: \$5 million GST Exemption & 35% GST Tax rate

For 2011, there is a GST exemption of \$5 million, and a 35% GST tax rate.

For 2012, the \$5 million GST exemption will be adjusted for inflation. 35% GST tax rate.

For 2013 and beyond, the GST exemption reverts to approximately \$1.4 million and the GST tax rate will be 55%, *unless Congress.....*

This \$5 million GST exemption presents a HUGE WINDOW OF OPPORTUNITY FOR NEXT 2 YEARS to remove wealth from federal transfer tax system.

BEHIND THE HEADLINES: Capital Gain income tax rate stays at 15%

For 2011-12: the maximum capital gains rate is 15%.

For 2013 and beyond: the maximum capital gains rate is 23.8%.

For 2011-12: the maximum income tax rate is 35%.

For 2013 and beyond: the maximum income tax rate is 43.4%. (39.6% for earned income.)

For 2011-12: the maximum dividend tax rate is 15%.

For 2013 and beyond: the maximum dividend tax rate is 43.4%.

BEHIND THE HEADLINES: 2010 Decedents can elect carryover basis and no estate tax

Decedents who died in 2010 are in the estate tax system with a \$5 million exemption and full stepped-up basis (the “2011 \$5 Million Regime”), *unless* they elect to be governed by the no estate tax & limited step-up of 2010 (the “2010 Carryover Regime”).

2010 decedents with estates less than \$5 million should go with the 2011 \$5 Million Regime.

2010 decedents with estates over \$5 million should *probably* elect the 2010 Carryover Regime, *but not in all cases*.

Tennessee inheritance tax is owed regardless of the federal election.

BEHIND THE HEADLINES: Sunset on 12.31.2012

All these rules “sunset” on December 31, 2012, and we go back to the \$1 million exemption, 55% tax rate regime in 2013 and beyond....

Unless Congress extends these rules into 2013 and beyond or replaces these rules with new federal transfer tax laws.

Politics, elections, economy, budget deficits—get out your crystal ball, fasten your seat belts and expect the unexpected.

All the more reason to take advantage of the 2 YEAR WINDOW OF OPPORTUNITY.

THE RECAPTURE TAX CONCERN

What if....a client makes a \$5 million gift in 2011 or 2012 to take advantage of the window of opportunity, then dies in 2013 when the estate tax exemption is only \$1 million (or some other amount that is less than \$5 million)?

Some commentators are calling this the “clawback.” We’re calling it the recapture tax.

THE RECAPTURE TAX CONCERN (cont.)

If any optimists still exist with respect to federal tax policy, these optimists maintain that Congress will clear up this uncertainty by a technical correction or other means to clarify that tax-free gifts lawfully made in 2011 & 2012 will not be subject to future estate taxes if exclusions in 2013 and beyond are decreased to less than \$5 million.

We're watching this issue. The possibility of recapture has to be reckoned with. We're optimists on this one—we recommend that clients take advantage of the 2 year window of opportunity.

SPECIFIC ISSUES FOR TENNESSEE RESIDENTS

Tennessee still has its gift tax. If a client takes advantage of the \$5 million gift & GST exemptions in 2011 and 2012 the Tennessee gift tax on a \$5 million gift is \$463,400.

For married couples, if each spouse made a \$5 million gift of separately-owned assets, the total Tennessee gift tax would be \$926,800 ($\$463,400 \times 2 = \$926,800$).

If gift splitting was elected and one spouse made a \$10 million gift, the Tennessee gift tax on the \$10 million gift would be \$938,400.

SPECIFIC ISSUES FOR TENNESSEE RESIDENTS

(cont.)

Married persons can avoid the Tennessee gift tax by making the gift to an *inter-vivos QTIP for the surviving spouse*, but that will cause the trust assets to be subject to Tennessee inheritance tax at the surviving spouse's death.

The Tennessee inheritance tax exemption remains at \$1 million.

The Tennessee Community Property Trust is a great way to assure that spouses can fund Bypass/Credit Shelter Trusts.

TAKING ADVANTAGE OF THE 2-YEAR WINDOW OF OPPORTUNITY

The prototype Will for a married person will transfer \$1 million to a traditional credit shelter trust and \$4 million to a Tennessee QTIP Trust.

Formula Wills drafted in the last 10 years may already create this result.

The first spouse to die needs to have \$5 million of assets in order to fully benefit from the higher exemption.

It may be necessary to re-title assets.

Eliminate joint ownership between spouses.

Consider a Tennessee Community Property Trust.

TAKING ADVANTAGE OF THE 2-YEAR WINDOW OF OPPORTUNITY (cont.)

\$5 million gift to GST-Exempt Trust for Rule Against Perpetuities period (360 years in Tennessee). Use inter vivos QTIP to avoid Tennessee gift tax.

Short-term GRATs were not outlawed by the new Act but they remain on the “endangered species” list.

Discounting is still allowed by the new Act but it remains on the “endangered species” list as well.

Installment sales to IDGTs. Ability to gift additional seed money to IDGT to increase trust’s capacity to purchase assets from grantor.

TAKING ADVANTAGE OF THE 2-YEAR WINDOW OF OPPORTUNITY WITH LIFE INSURANCE (cont.)

Once clients have bought into this “window of opportunity” to make large gifts of up to \$10 million to a GST-Exempt Trust, life insurance is a great product for the trust to purchase and own.

See attached Pacific Life illustration.

IRA CHARITABLE ROLLOVERS

The new Act allows IRA account owners who are older than 70½ years to transfer up to \$100,000 per year from their IRA to a public charity.

The distribution will not count as taxable income. The distribution will count towards the owner's RMD.

This law applies for 2010 and 2011.

IRA CHARITABLE ROLLOVERS (cont.)

If the owner did not make a charitable rollover in 2010, the owner may give up to \$200,000 in 2011. *However, only \$100,000 may be transferred after January 31, 2011.*

The January rollover can satisfy the owner's 2010 RMD. However, if the owner already received his RMD, there is no way to convert it to a charitable rollover.

**Possible Death Benefits
for \$1,000,000 and \$2,000,000
Single Premium Deposits**

**Single Life, Male, Preferred Nonsmoker
Lifetime Guarantee Death Benefit**

| <i>Age</i> | <i>\$1,000,000</i> | <i>\$2,000,000</i> |
|------------|--------------------|--------------------|
| 55 | 3,704,593 | 7,414,947 |
| 65 | 2,540,085 | 5,083,421 |
| 75 | 1,729,465 | 3,460,737 |

**Survivorship Life, Male and Female Preferred Nonsmokers
Guaranteed to 89, to Age 120 Based on current assumptions**

| <i>Ages</i> | <i>\$1,000,000</i> | <i>\$2,000,000</i> |
|-------------|--------------------|--------------------|
| 55/55 | 6,094,635 | 12,215,609 |
| 65/65 | 3,696,789 | 7,408,868 |
| 75/75 | 2,351,852 | 4,712,761 |

Life Insurance Assumptions: Single Life: Pacific Life Insurance Company's Versa Flex No Lapse Guarantee (Policy Form #P08VN1) universal life policy and includes the Flexible Duration No Lapse Guarantee Rider (Form #R03FNL). Survivorship Life: The Pacific Life Insurance Company's indexed Pacific Estate Preserver (Policy Form #P09IEP) indexed universal life insurance product. Assumed crediting rate of 5.35% (guaranteed crediting rate is 2%). 100% allocated into the Fixed Account. The Medium Duration No Lapse Guarantee Rider (Form #R03FNL) is included in the illustration. This policy does not directly participate in any stock or equity investments.

Pacific Life Insurance Company is licensed to issue individual life insurance and annuity products in all states except New York. Product availability and features may vary by State. Pacific Life Insurance Company's Home Office is located in Newport Beach, CA.

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