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New Tax Law Creates Opportunity for Major Gift Planning in 2011 and 2012 and Temporarily Alleviates Estate Tax Threat

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Act). In general, the Act provides tax relief for gift, estate and generation-skipping transfer (GST) tax purposes by lowering tax rates and increasing exemptions, but only for 2011 and 2012. Key changes are as follows:

Increased Gift, Estate, and GST Exemptions for 2011 and 2012

For 2011 and 2012, the gift, estate and GST taxes are unified

\$5 million exemption for each tax

Flat 35 percent rate for each tax

All tax rates and exemptions will "sunset" again after 2012

\$1 million gift, estate and GST exemptions are currently scheduled for 2013

Maximum tax rate of 55 percent is currently scheduled to return in 2013

Important Tax Facts from the Act for Estate Planning Clients

	2011	2012	2013
Gift Tax Exemption	\$5,000,000	\$5,000,000 ¹	\$1,000,000
Maximum Gift Tax Rate	35%	35%	55%

Estate Tax Exemption	\$5,000,000	\$5,000,000 ¹	\$1,000,000
Maximum Estate Tax Rate	35%	35%	55%
GST Exemption	\$5,000,000	\$5,000,000 ¹	\$1,400,000 ²
GST Tax Rate	35%	35%	55%
Top Income Tax Rate	35%	35%	39.6%
Top Capital Gains Rate ³	15%	15%	20%
Social Security Payroll Tax	4.2%	6.2%	6.2%

¹ This amount will be indexed for inflation.

² The 2013 GST Exemption is to be adjusted for inflation. The amount of \$1.4 million is a rough estimate.

³ The capital gains rate for collectibles and certain depreciable property is higher.

A Golden Gifting Opportunity: For 2011 and 2012, the gift tax exemption is a surprising \$5 million, or \$10 million per couple. This large increase in the gift tax exemption was not anticipated. With a \$14.1 trillion national debt, future gift and estate tax laws may be significantly more onerous. We should not assume the estate and gift tax system has stabilized at the current levels, as there remains a tremendous amount of uncertainty over what they will be in the future. This generous gifting window closes in 2013, when it is scheduled to go back to \$1 million. ***This may prove to be the best time ever to shelter assets from the estate taxes through lifetime gifting strategies.*** For example, President Obama's current budget plan includes a baseline assumption that the estate tax exemption after 2012 will return to 2009 levels (\$3.5 million exemption and 45% estate tax rate). Note that in 2009 the gift tax exemption was only \$1 million.

Why Consider Gifting?

Avoid Paying Estate Taxes on Future Income and Appreciation: If a \$5 million gift were to grow to \$15 million by the time of the donor's death, the estate tax savings could be \$5.5 million (55% of the \$10 million of appreciation). In addition, all income from the gifted assets will be out of the donor's taxable estate.

Asset Protection: Doctors, lawyers and others who wish to shelter assets from possible future claims can shift assets to special types of trusts to shield assets from both estate taxes and creditors.

Family Gifting Trusts: Spouse A creates an irrevocable trust for the benefit of Spouse B and/or their descendants, and funds it with a \$5 million gift. Spouse B is the Trustee. Spouse B can distribute funds from the trust for his or her and/or the other beneficiaries' health, education, maintenance and support. Spouse B has full control of the trust's assets. None of the assets in this trust should be includable in either spouse's taxable estate, and the trust's assets should also be exempt from creditors. To enhance the estate tax savings, Spouse A could also lend funds to the trust at the currently low Applicable Federal Rates (AFR), so that the income in excess of the AFR and the future appreciation of the loan amount then accrues to the trust, safe from estate taxes. Moreover, this doesn't have to be a one-way street. With special care to avoid the reciprocal trust doctrine, Spouse B can also establish a trust for Spouse A's benefit.

Gift Splitting: Through a technique called gift splitting, a married couple can agree to treat gifts made by either of them to others as if the gift were made equally by each of them. With gift splitting, either spouse may make a gift of up to \$10 million. This is an excellent way for a wealthy spouse to use the exemption of a less wealthy spouse whose exemption may otherwise be wasted.

Business and Farm Succession Planning: To avoid estate tax on the family business or family farm, while still retaining control of the entity, consider making a gift of nonvoting stock or limited partnership interests. The valuation discount on these types of ownership interests leverages the gift tax exemption, allowing it to stretch farther. Nothing in the Act adversely impacts this type of gift planning.

Additional Insurance for Gifts or Sales of Hard-to-Value Assets to Trusts: The larger gift tax exemptions create additional cushion against the possibility of gift taxes being imposed on gifts and sales of hard-to-value assets, such as limited partnership interests or ownership interests in

closely held businesses, to irrevocable family gifting trusts.

Avoidance of State Estate Taxes: Many states impose their own estate taxes at the state level. Making gifts such as those described above also helps to avoid state estate taxes. However, some states impose state level gift taxes, and in such states, state gift tax implications need to be considered.

Sheltering Family Wealth from Estate and Generation Skipping Taxes into Perpetuity:

We nearly always recommend that substantial family gifting be done through irrevocable trusts. These trusts, sometimes called Dynasty Trusts or Generation-Skipping Trusts, can be structured so that they should be sheltered from estate taxes and generation-skipping taxes, even into perpetuity in the states that permit perpetual trusts. Assets in these types of trusts should also be sheltered from attack by the beneficiaries' creditors. Trust gifting also allows the donor to specify how the assets will pass to or for the benefit of her or his beneficiaries in the future, usually so the assets remain exclusively for the donor's descendants. Outright gifts offer none of these advantages.

What This Means to You

Due to this major change in the tax law, we recommend that you schedule a meeting with your Husch Blackwell estate planning attorney to determine how best to take advantage of the significant planning opportunities the Act provides.

Contact Info

If you have questions about this or any other Trusts & Estates matter, contact your Husch Blackwell attorney.

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