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Estate Planning Alert

December 2010

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Tax Bill Provides Long-Awaited Clarity Regarding Estate, Gift and GST Taxes

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (H.R. 4853) has provided long-awaited clarity for private wealth advisers and their clients, as well as some valuable planning opportunities. President Obama signed the bill on December 17, 2010. As is the case with any new legislation, however, the Act does include a few traps for the unwary.

Estate Tax: For individuals dying in 2010, 2011 or 2012, the Act generally restores the "old" estate tax rules with a $5,000,000 exemption (adjusted for inflation in 2012) and a 35 percent estate tax rate. Estates and beneficiaries will also receive a stepped-up basis in the decedent's assets for income tax purposes. However, for some decedents dying in 2010, it may be more advantageous to have the estate tax repeal and carryover basis rules apply. In such cases, the personal representative must file an election to do so. Personal representatives will have nine months after the Act became effective (until September 17, 2011) to file an estate tax return or make the carryover basis election, if necessary. Also, subject to state law limitations, any beneficiary of a 2010 estate will have the same extended nine-month period to disclaim all or a portion of an inheritance, provided he or she has not already accepted any benefits from it.

All personal representatives administering 2010 estates will need to act, even if the estate has already been closed:

- If the estate is $5,000,000 or more, the personal representative must file either an estate tax return or an election to have the repeal/carryover basis rules apply.
- If the estate is less than $5,000,000, the personal representative should notify beneficiaries of any increase in their basis due to the stepped-up basis rules.
- In the case of beneficiaries who have not yet received any part of their inheritance, the personal representative should notify them that they may have additional time to consider making a disclaimer.

Under the new estate tax rules, individuals dying in 2011 or 2012 (but not those dying in 2010) can pass any unused estate tax exemption on to their surviving spouses. To transfer the remaining exemption, the individual's personal representative must file an estate tax return (even if one would not otherwise be required) and elect to allow the surviving

spouse to use the exemption. For estate planning purposes, this "portability" provision will reduce (but not necessarily eliminate) the need to transfer assets between spouses to equalize their estates and the need to set up "credit shelter" or "by-pass" trusts to minimize estate taxes.

Gift Tax: The Act does not change the gift tax rules for 2010 gifts:

Any 2010 gift in excess of the donor's annual exclusion ($13,000 per donee) will reduce the donor's $1,000,000 lifetime exemption; and gifts in excess of the exemption are subject to a 35 percent gift tax.

For gifts in 2011 and 2012, the lifetime gift tax exclusion is increased to $5,000,000 (adjusted for inflation in 2012).

As always, any portion of a donor's lifetime gift tax exclusion used will reduce the estate tax exemption available at death.

GST Tax: The Act's effect on the generation-skipping transfer (GST) tax rules is complicated. Generally, beginning in 2010 and continuing through 2011 and 2012, each individual may give up to $5,000,000 to grandchildren or more remote descendants ("skip persons") without incurring an additional GST tax of 35 percent. In addition, any transfer in 2010 that is technically subject to the GST tax is taxed at a 0 percent rate. This provides a tremendous, but temporary, opportunity for (1) individuals who would like to make sizeable transfers to skip persons and (2) fiduciaries and beneficiaries of existing estates or trusts that are subject to the GST tax, ***but only if action is taken before January 1, 2011***.

- For lifetime transfers, the Act makes it clear that 2010 gifts to custodians or trusts for the benefit of skip persons will not be subject to a GST tax in the future (assuming no future retroactive change in the law). As an additional benefit, any such transfer made in 2010 will not require the donor to use any of his lifetime GST exclusion, provided he reports the GST on a timely filed gift tax return and ***elects out of the automatic allocation of his GST exemption***. Of course, a sizeable gift in 2010 may trigger the 35 percent gift tax described above. For some, though, payment of gift tax will be a good "investment" if they can shelter significant amounts from estate and GST taxes, while retaining their ability to make up to $5,000,000 in additional GST gifts in the future.
- For trustees of trusts that are not exempt from the GST tax, serious consideration should be given in the final days of 2010 to making sizeable distributions to skip persons, or perhaps even terminating the trust before the end of 2010, if possible, to take advantage of the 0 percent tax rate.
- For personal representatives of large, complex estates, the new GST rules may require rethinking decisions regarding the timing of distributions and the allocation of the decedent's GST exemption.

In addition to the normal GST tax reporting rules for 2010, ***any donor, trustee or personal representative who made a gift or transfer to a skip person before December 17, 2010, must file a tax return to report it***, but will have until September 17, 2011, to do so.

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