Why You Need to Review Your Estate Plan Now

On December 17, 2010, The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "2010 Act") was signed into law by President Barack Obama. The 2010 Act extends the sunset of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") for 2 years and makes significant changes to the estate, gift and generation-skipping transfer tax laws. If there were ever a time to review how these changes affect your estate plan, now is the time!

Estate Tax

Absent the enactment of the 2010 Act, as a result of the sunset of EGTRRA on December 31, 2010, the federal estate tax exemption amount would have been reduced to $1,000,000 and the top estate tax rate would have increased to 55%. Under the terms of the 2010 Act, not only has the sunset of EGTRRA been postponed until December 31, 2012, but for 2010[1], 2011 and 2012, the estate tax exemption is set at $5,000,000 and the estate tax rate is 35% for amounts in excess of the $5,000,000 exemption. However, if no further legislation is enacted on or before December 31, 2012, the estate tax exemption amount will decrease to $1,000,000 (indexed for inflation), with a 55% top estate tax rate beginning on January 1, 2013.

	2010	**2011 – 2012**	**2013 and beyond****
Estate Tax Exemption	$5,000,000	$5,000,000*	$1,000,000
Estate Tax Rate	35%	35%	55%

*As indexed for inflation in 2012
**Absent further legislation, and as indexed for inflation

Impact of 2010 Act on Formula Clauses

In order to ensure that no federal estate tax will be due until the death of the second spouse, while at the same time taking maximum advantage of the available federal estate tax exemption, the estate plan of a married couple will frequently be crafted using a formula clause providing that the maximum federal estate tax exemption amount will pass to a "Family Trust" (also known as a "Credit Shelter Trust") upon the death of the first spouse and the balance of the estate will either be distributed outright to the surviving spouse or, alternatively, pass to a Marital Trust. Because the federal estate tax exemption has increased a number of times since 2001, a formula clause is typically used instead of referencing a particular dollar amount in order to avoid the necessity of revising the Will whenever the exemption amount changes. However, with the significant increase in the federal estate tax exemption to $5,000,000, the desired amounts may not pass to the correct parties under your current estate planning documents. Rather than including a formula clause, you may find that it's now more appropriate to reference a specific dollar amount in your documents.

In addition, because certain states (including New York, Connecticut and New Jersey) have "decoupled" their state estate tax exemption from the federal estate tax exemption, if a formula clause in a Will is set to the federal exemption amount then, as a result of the increase in the federal exemption amount, more state estate tax will be due upon the death of the first spouse to die than had been the case in prior years. For example, a New York decedent's estate governed by a formula clause tied to the federal exemption amount would owe New York State estate tax on the $4,000,000 by which the federal exemption amount exceeds New York State's lower $1,000,000 exemption amount, resulting in a $391,600 New York State estate tax bill. What this all amounts to is that your current Wills with formula clauses may not reflect your current wishes and should be reviewed immediately. Married clients who have less than $10 million may be most affected by these changes.

TAKEAWAY: Review your estate planning documents to ensure that the desired amount will pass to the correct parties.

Portability

In addition to temporarily increasing the estate tax exemption amount and decreasing the top estate tax rate, the 2010 Act also includes a new "portability" provision for decedents dying in 2011 or 2012 which allows the executor of a deceased spouse's estate to transfer any unused estate tax exemption to the surviving spouse for use either in connection with lifetime gifting or for use upon the surviving spouse's later death.

For a host of reasons, including the fact that it is unclear whether portability will survive past 2012, individuals should not rely on portability as a planning tool. Instead, it is essential that individuals still include appropriate tax planning techniques (i.e., a "credit shelter trust") in their estate planning.

Gift and Generation-Skipping Transfer Tax

For 2011 and 2012, the total lifetime gift tax and generation-skipping transfer tax exemptions available to an individual are increased from $1,000,000 to $5,000,000. Unless Congress acts to extend the provision, the exemptions will return to $1,000,000 (indexed for inflation) with a 55% tax rate as of January 1, 2013.

	2010	**2011 - 2012**	**2013***
Individual Lifetime Gift Tax Exemption*	$1,000,000	$5,000,000**	$1,000,000
Gift Tax Rate	35%	35%	55%

*Reduced by any amount of lifetime gift tax exemption previously used
**As indexed for inflation in 2012
***Absent further legislation, and as indexed for inflation

Individuals who have already used $1,000,000 of their lifetime exemption can use an additional $4,000,000 of exemption in 2011 or 2012 without paying gift or generation-skipping transfer tax. As under the law prior to the 2010 Act, the estate tax exemption will be reduced by the amount of gift tax exemption used during an individual's lifetime.

For a married person whose spouse consents to allowing the use of his or her gift or generation-skipping transfer tax exemption through a process called "gift splitting," the lifetime gift and generation-skipping transfer tax exemption amount is doubled to $10,000,000.

TAKEAWAY: We strongly encourage clients to reconsider their lifetime gifting plans in light of the favorable planning environment provided by the 2010 Act. These opportunities are scheduled to be severely curtailed after 2012.

Making outright gifts or gifts to trusts removes from an individual's estate the gifted property as well as any future income or appreciation related to that property. It may also shift income producing assets to individuals subject to lower income tax rates. The increased gift tax exemption allows for the amplification of these benefits (e.g. through use of leveraging techniques). Non-married partners may wish to make significant gifts now using the increased exemption.

Traditional planning techniques utilizing valuation discounts and low interest rates remain available to further leverage the exemption. For example, a lack of control and marketability may discount the fair market value of certain assets. Assuming a 33.33% discount on the assets transferred, a married couple that has not used any of their lifetime gift tax exemption could transfer up to $15,000,000 in total wealth in 2011 or 2012 without incurring a gift tax. Clients with large life insurance policies may wish to consider the possibility of utilizing the increased exemption to transfer the policies to an irrevocable trust.

For those wishing to take advantage of the increased exemption, but hesitant to make large irrevocable gifts, a transfer of property to a "self-settled" trust may be appropriate. In certain states, self-settled trusts permit the settlor to retain a discretionary interest in the transferred property, while protecting it from the settlor's creditors. The IRS has recently ruled that such a trust will not be included in the settlor's estate provided there is no implied understanding or pre-existing agreement regarding the trustee's discretion to distribute income or principle to the settlor.[2] Opportunities may also exist for individuals who have previously made gifts to trusts for their descendants to allocate GST tax exemption to those trusts, to the extent that they are not already exempt, or to make additional gifts to trusts which are already GST exempt.

President Obama's Budget Proposal of February 2011

Over the past year, numerous proposals have been made to enact legislation which would place certain restrictions on the use of Grantor Retained Annuity Trusts ("GRATs"), including proposals to require that GRATs contain a minimum 10-year "term" which would largely make them inappropriate for use by older individuals and those who anticipate significant short term appreciation. The 2010 Act did not contain any such provisions with respect to GRATs, and, therefore, it remains possible to create GRATs for potentially significant gift and estate tax savings. In addition, since GRATs benefit from low interest rates, they continue to be an attractive planning technique in this low interest rate environment. However, President Obama's budget proposal includes legislation which would place restrictions on GRATs as well as restrictions on the use of discounts. Additionally, the proposal includes limiting the duration of dynasty trusts to 90 years.

Due to the real possibility of tax reform legislation which would curtail the benefits of gifting to perpetual trusts, together with the expiration of the increased exemption in 2013, the possibility of reinstatement of gift tax by states that face record budget deficits, current depressed asset values

and historically low interest rates, clients should not wait to take advantage of the current gifting opportunities.

We urge readers to contact their Moses & Singer attorney to explore how these changes should be implemented.

---

1. The executor of the decedent's estate may elect to "opt out" of the 2010 estate tax regime and instead secure an unlimited exemption, provided, however, that such election also requires that the executor elect into a carryover basis regime.

2. http://www.mosessinger.com/articles/files/AlaskaSelfSettledTrust.pdf

MOSES & SINGER LLP

Lawyers in Moses & Singer's Trusts and Estates and Asset Protection practice groups are internationally recognized for their considerable skill and extensive experience in the fields of estate planning and wealth preservation. Our lawyers provide a full range of tax and estate planning services to corporate executives, entrepreneurs, and other high-net-worth individuals. In addition to experience in the traditional areas of will and trust drafting and estate administration, our attorneys excel in the latest techniques to effectively plan for business succession while minimizing taxes and preserving and protecting clients' wealth from potential creditor risks. The client’s personal objectives and wealth preservation goals are integrated into the estate planning process.

Gideon Rothschild
Co-Chair
212.554.7806
grothschild@mosessinger.com

Irving Sitnick
Co-Chair
212.554.7821
isitnick@mosessinger.com

Lori Anne Douglass
212.554.7803
ldouglass@mosessinger.com

Daniel S. Rubin
212.554.7899
drubin@mosessinger.com

Arthur M. Schneck
212.554.7825
aschneck@mosessinger.com

Alvin H. Schulman
212.554.7888
aschulman@mosessinger.com

Ira W. Zlotnick
212.554.7870
izlotnick@mosessinger.com

Kerrie C. Horrocks
212.554.7827
khorrocks@mosessinger.com

Vanessa L. Kanaga
212.554.7859
vkanaga@mosessinger.com

Alan H. Kupferberg
212.554.7805
akupferberg@mosessinger.com

Jenna R. Millman
212.554.7877
jmillman@mosessinger.com

Since 1919, Moses & Singer has provided legal services to diverse types of businesses and high-net-worth individuals. Among the firm's broad array of U.S. and international clients are leaders in banking and finance, entertainment, media, real estate, healthcare, advertising, and the hotel and hospitality industries.

In a world of giant, multi-office law businesses assembled by mergers, built on associate leverage and driven by billable hour quotas, the needs of clients can get lost. Moses & Singer offers a difference. That difference is the attention of leading practitioners-partners in the firm-with the experience and knowledge to provide our clients creative, cost effective, result-oriented representation. The direct involvement of our partners means aggressive, focused problem solving. The firm's attorneys concentrate their practices in the following areas:

- Advertising
- Asset Protection
- Banking and Finance
- Business Reorganization, Bankruptcy and Creditors' Rights
- Corporate/M&A
- Employment and Labor
- Entertainment
- Healthcare
- Hotel and Hospitality
- Income Tax
- Intellectual Property
- International Trade
- Internet/Technology
- Legal Ethics & Law Firm Practice
- Litigation
- Matrimonial and Family Law
- Privacy
- Private Funds
- Promotions
- Real Estate
- Securities and Capital Markets
- Trusts and Estates

The Chrysler Building
405 Lexington Avenue
New York, NY 10174-1299
Tel: 212.554.7800 Fax: 212.554.7700

2200 Fletcher Avenue
Fort Lee, NJ 07024
Tel: 201.363.1210 Fax: 201.363.9210
Abraham Y. Skoff, Esq.
Managing Attorney for New Jersey

Moses & Singer LLP is the New York City law firm member of the MSI Global Alliance (MSI). MSI is one of the world's leading international alliances of independent legal and accounting firms, with over 250 member firms in 100 countries - www.msiglobal.org.

Disclaimer
Viewing this or contacting Moses & Singer LLP does not create an attorney-client relationship.

This is intended as a general comment on certain developments in the law. It does not contain a complete legal analysis or constitute an opinion of Moses & Singer LLP or any member of the firm on the legal issues herein described. This contains information that may be modified or rendered incorrect by future legislative or judicial developments. It is recommended that readers not rely on this general guide in structuring or analyzing individual transactions or matters but that professional advice be sought in connection with any such transaction or matter.

Attorney Advertising
It is possible that under the laws, rules or regulations of certain jurisdictions, this may be construed as an advertisement or solicitation.

Copyright © 2011 Moses & Singer LLP
All Rights Reserved