ESTATE PLANNING OPPORTUNITIES FOR 2010 --
ACT NOW -- LIMITED TIME OFFER!

The failure of Congress to address the federal estate, gift and generation skipping tax prior to January 1, 2010 creates estate planning opportunities in 2010 for clients who are in a position to make large gifts and are willing to take the risk that Congress will enact retroactive changes to the law which will nullify the benefit of these gifts. To recap, as the law stands today, there is no federal estate tax for individuals who die in 2010, generation skipping tax is not imposed for transfers made in 2010 and the gift tax rate for taxable gifts made in 2010 is a relatively modest 35%. This transfer tax landscape creates the following planning opportunities for the right client:

1. Make taxable gifts in 2010 subject to the 35% gift tax rate. For gifts made in 2009, the highest marginal gift tax rate was 45% and, assuming there is no change in the law, for gifts made in 2011, the highest marginal gift tax rate will be 55%. Therefore, a 35% gift tax is relatively cheap. The term "taxable gifts" means gifts in excess of the annual exclusion and which do not qualify for the unlimited education or healthcare exclusion. Taxable gifts are subject to gift tax when cumulatively they exceed the donor's $1,000,000 lifetime gift tax exemption. Paying gift tax at 35% is relatively inexpensive in comparison to the 45% maximum marginal federal estate tax rate which applied in 2009 and the 55% maximum marginal federal estate tax rate which is scheduled to apply in 2011.

   This planning opportunity is especially attractive for individuals who are already making taxable gifts and who would consider increasing the size of their gifts in order to take advantage of the lower rate.

   Gifts contemplated by this planning opportunity include not only traditional gifts from donor to donee (including a trust), but also the release of a general power of appointment held by the beneficiary of a trust, which is also treated as a gift for gift tax purposes. A "general power of appointment" is a power held by a beneficiary to direct the distribution of trust property, during life and/or at death, to the beneficiary him/herself, his or her estate, his or her creditors or the creditors of his or her estate.

2. Make gifts in 2010 to grandchildren or more remote descendants or to other generation "skip" persons or to trusts the sole beneficiaries of which are such individuals. Normally, gifts of this type would be subject to generation skipping tax if and to the extent they exceed the generation

skipping tax exemption, but as the law stands today, in 2010 there is no generation skipping tax so gifts of this type are very attractive. The benefit of such gifts is that they "skip" the intermediate generation so they save estate or gift tax for the members of that generation.

3. Trusts which are likely to terminate in the not-to-distant future and which at that time would be distributable to one or more wealthy individuals present a unique opportunity for estate planning. Trustees and beneficiaries might explore ways under the governing instrument or state law to terminate the trust prior to its natural termination date and distribute the funds to the beneficiaries who then make taxable gifts subject to the 35% gift tax rate as described in paragraph 1 above or generation skipping gifts as described in paragraph 2. The benefit of this plan is that the funds which would otherwise be includible in the beneficiary's estate after the trust terminates are gifted away at a reduced rate of tax. In addition to the other risks described in this piece, a risk to this transaction is that one or more of the beneficiaries die prior to the trust's natural termination date, which means in most cases (*but see* next paragraph) that there would have been no inclusion for federal estate tax purposes in the estate(s) of that/those beneficiary(ies). Also, for this plan to work, the beneficiaries must be similarly situated and cooperative.

   This plan is especially attractive where the trust principal will be includible in the estate of the beneficiary no matter when he or she dies, such as where the beneficiary possesses a general power of appointment or the trust is a marital deduction trust.

It is possible that Congress will pass and the President will sign transfer tax legislation this year which will be retroactive to January 1st and which would re-establish the federal estate and/or generation skipping tax for 2010 and/or increase the gift tax rate for 2010. It is unclear if and the extent to which the retroactive application of the new laws would pass constitutional muster. In any event, any client who embarks on any of these estate planning techniques must be advised that a change in the law could diminish or eliminate the efficacy of the plan and be willing to assume that risk.

Although the following planning opportunity is not a product of Congress' failure to act, like the planning opportunities presented above, it may be a short-lived opportunity. It relates to a grantor retained annuity trust (GRAT) which is a trust which pays to the donor a specified dollar amount for a term of years, and after the end of the term of years the GRAT terminates in favor of children or other beneficiaries. A benefit of a GRAT is that the value of the gift for gift tax purposes on creation of the GRAT is reduced by the value of the right the donor retains to receive the dollar-amount payments.

Under present law the period of years of the GRAT can be any number of years. If the donor dies during the term of the GRAT, all or some portion of the principal of the GRAT is includible in his or her estate for federal estate tax purposes and when that occurs a primary benefit of the GRAT is eliminated. A shorter period of years minimizes the risk of premature death. Consequently, many GRATs are drafted with two or three year terms of years.

Under the Small Business and Infrastructure Jobs Tax Act which passed the House on March 24, 2010, the term of years of all GRATs must be no less than 10 years. Also, the value of the gift on creation of the GRAT cannot be zero. Were these changes passed by the Senate and signed into law by President Obama, the benefit of GRATs would be significantly reduced. Therefore, for clients who are contemplating short-term and/or so called “zeroed out” GRATs, the window of opportunity to establish them may be closing and they should act quickly.

If you or your clients have questions about any of the proposals made in this piece or would like to address estate planning generally, please contact a member of Montgomery McCracken’s Trusts and Estates Section.

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