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# Estate & Gift Tax Update & Opportunities

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Some of the most significant and taxpayer-friendly tax law changes over the past year were in estate and gift taxes. After years of uncertainty, the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*, enacted on December 17, 2010, appears to have provided a two-year period of certainty that will end December 31, 2012. The changes provide for unprecedented opportunities during this two-year time span.

**Gift Tax**

The most sweeping changes occurred in gift taxes. The gift tax exemption was reunified with the estate tax exemption at $5 million effective January 1, 2011, and with an inflation adjustment for years after 2011; the 2012 exemption is $5.12 million. This is an increase of $4 million over the previous level. Through 2012, all individuals can give away the additional $4 million—$8 million for married couples—while those who have not previously made taxable gifts can give the entire $5 million. The maximum tax rate through 2012 was set at 35 percent, the lowest rate since 1975. Those who don't take advantage of this window of opportunity before 2013 may find unused amounts subject to gift or estate tax at higher rates in the future. Without congressional intervention, the exemption will return to $1 million with a top rate of 55 percent in 2013.

Although heavily debated, no changes were made to the gift tax laws that would curtail many of the estate-planning techniques used in the past to minimize estate taxes. As these techniques will likely be an ongoing topic of discussion in the budget debates, there can be no assurances that they will be available into the future. The following are just a few of the items that will continue to be discussed during 2011 and 2012 with clients who are considering family transactions:

**Large Taxable Gifts** – Those with substantial estates should consider taking advantage of some or all of the new $5 million lifetime exemption. To further enhance the gift, a discount vehicle should be considered.

**Lifetime Credit Shelter Trust** – For married couples, one way to take advantage of the new exemption is to establish a qualified trust for the spouse's benefit. These trusts have the added benefit of the principal remaining accessible as long as both spouses are living and remain married. Properly structured, trusts can be established for each spouse to take advantage of the full $5 million exemption.

**Family Limited Partnerships** – Although heavily debated, current law continues to allow the use of these vehicles, which can produce substantial discounts in the value of family assets. Coupled with already low asset values, this technique can be extremely helpful when handled properly.

**Grantor Retained Annuity Trust (GRAT)** – With the low interest rate environment, the GRAT will continue to be an excellent vehicle to shift wealth tax-free to future generations in 2011 and 2012. The

short term GRAT (two to five years) utilized by many will be a continued topic of discussion in Congress for periods after 2012, so utilization now may be prudent.

**Qualified Personal Residence Trust (QPRT)** – The higher exemption, combined with a depressed real estate market, can make a QPRT an ideal way to transfer a residence or vacation home to the next generation at a substantial discount.

**Low-Interest-Rate Transactions** – Many planning techniques are much more effective when interest rates are low. Among those are outright sales in return for a note, sales to defective trusts, gifts to a GRAT or gifts to a charitable lead trust.

**General Estate Plan Cleanup** – With the added exemption available, this is a great time to forgive lingering loans to children or equalize gifts between children.

**Annual Exclusion Gifts** – For 2011 and 2012, tax-free gifts of up to $13,000 can be made to any number of recipients.

**Estate Tax**

The estate tax exemption was also increased for 2011 and 2012 to the $5 million level (with inflation adjustment after 2011) with a top rate of 35 percent. Without congressional action by the end of 2012, the exemption will once again drop to $1 million with a top rate of 55 percent.

While most experts don't expect this will happen, there is no assurance that the $5 million exemption level will be maintained.

President Obama's budget proposals have consistently called for a $3.5 million exemption and higher rates. Perhaps the most intriguing aspect of the estate tax law changes is the introduction of the concept of portability of any unused exemption at death to a surviving spouse. An election to take advantage of the portability provisions must be made on a timely filed federal estate tax return at the first death. While this election can salvage some poor planning, it should not be used as a substitute for traditional estate planning for larger estates, and it is only effective for deaths occurring before 2013.

Due to budget restraints, many states continue to decouple from the federal estate and gift tax system and impose their own tax regime. You should review the current status of the estate and gift tax system in your state of residence.

**Generation-Skipping Tax (GST)**

Since the estate tax laws are structured to tax net worth at each generation, limitations have been placed on the amount an individual can transfer beyond the first generation. If transfer amounts exceed these levels, an additional tax can be levied over and above the normal gift and estate tax. For 2011 and 2012, the GST exemption also has been set at $5 million (with inflation adjustment after 2011), with a top rate of 35 percent.

With uncertainty for years after 2012, it is imperative that clients review their estate and gift tax situations. Failure to do so could result in substantial financial cost to your family. Due to the complex nature of estate planning and the fact that all situations differ, you should consult your BKD advisor to discuss appropriate strategies.