GUNSTER

PRIVATE WEALTH SERVICES

Re: Estate Planning under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("TRUIRJCA" or the "2010 Tax Act")

Dear Clients and Friends:

As you are most likely aware, this past December Congress passed and the President signed into law legislation extending the "Bush Tax Cuts" for two years. The 2010 Tax Act contained significant changes to the estate, gift, and generation-skipping transfer ("GST") tax rules for 2011 and 2012. We are writing to advise you of these changes and potential planning opportunities that will exist during the next two years.

We also wanted to bring to your attention that the 2010 Tax Act reinstated the provision that allows individuals over age 70 ½ to make a direct distribution from their IRA to a charitable organization of up to $100,000 per year without including the distribution in gross income (no charitable deduction is allowed). The amount of the qualified charitable distribution counts against the individual's required minimum distribution for the year. Individuals may elect for distributions made by January 31, 2011 to be treated as made on December 31, 2010 which would allow the qualified charitable distribution to be used towards the individual's 2010 $100,000 charitable distribution limit and the individual's 2010 required minimum distribution. For individuals who received a required minimum distribution for 2010 before the end of 2010, it may be possible to roll over such distribution (if less than 60 days have passed since the distribution) and use a qualified charitable distribution made by January 31, 2011 to satisfy the 2010 required minimum distribution.

Tax Law Changes

The 2010 Tax Act made the following changes with regard to transfers in 2011 and 2012:

1. **Increase in Estate Tax Exclusion Amount and Reduction of Estate Tax Rate to 35%.** The 2010 Tax Act increased the "Applicable Exclusion Amount" for estate tax purposes to $5,000,000 per person and provided that the exclusion would be indexed for inflation. The Applicable Exclusion Amount is the aggregate amount that an individual can pass free of gift and estate tax, whether used during life, at death, or partially at each. Additionally, the estate tax rate is reduced to a 35% flat rate for estates in excess of the exclusion amount. The amount of estate tax exclusion available at death will continue to be reduced by exclusion utilized during life on taxable gifts.
2. **Portability of Unused Exclusion Amount.** The 2010 Tax Act added a provision that allows the Applicable Exclusion Amount of a surviving spouse to be increased by the unused exclusion amount of the predeceased spouse. The portability provision only applies where the first spouse dies after December 31, 2010, and, unless extended, before January 1, 2013. As discussed below, the portability provision may be helpful to those without proper planning, but does not replace the need for proper planning using credit shelter trusts nor eliminate the benefits of credit shelter trusts.
3. **Reunification of Gift Tax Exclusion Amount and Reduction of Gift Tax Rate to 35%.** In prior years, even as the estate tax exclusion amount increased, the gift tax exclusion amount remained at $1,000,000. The 2010 Tax Act "reunified" the gift tax exclusion amount with the estate exclusion amount, and as of January 1, 2011, the gift tax exclusion amount is also $5,000,000. Accordingly, even individuals who had previously utilized their full lifetime gift tax exclusion, and may have even paid gift tax, will have the ability to make $4,000,000 in additional taxable gifts without incurring additional gift tax liability. The 2010 Tax Act also reduced the gift tax rate to 35%.
4. **$5,000,000 GST Exemption and 35% GST Tax Rate.** Under the 2010 Tax Act, every individual has a $5,000,000 Generation-Skipping Transfer Tax Exemption [GST Exemption]. This GST Exemption is reduced by any GST Exemption previously allocated or deemed allocated to prior gifts. Unlike the unused estate tax exclusion, unused GST exemption at the first spouse's death is not transferrable to the surviving spouse. The 2010 Tax Act establishes a 35% tax rate for generation-skipping transfers occurring in 2011 and 2012.

What do the Changes Mean to You?

Reunification Makes Lifetime Gifts More Attractive

The most compelling estate planning opportunity created by TRUIRJCA is the ability to make substantial taxable gifts in 2011 and 2012 without incurring any gift tax. The reunification of the estate and gift tax exclusion amounts means that every individual has the ability to make at least $4,000,000 (and up to $5,000,000 if no prior taxable gifts were made) of taxable gifts without incurring a gift tax liability. A husband and wife could make taxable gifts of at least $8,000,000 (and potentially up to $10,000,000 if no prior gifts were made) without incurring gift tax.

Lifetime gifts are particularly beneficial from an estate planning perspective, as all post-gift appreciation accrues outside of the donor's transfer tax base. Additionally, lifetime gifts can be made through irrevocable trusts that create asset protection benefits for the beneficiaries. As a result of the increase in the GST exemption amount, a trust may be structured to continue for multiple generations (i.e., a "Dynasty Trust"), and you could allocate your GST Exemption to the gift to the trust so that the trust would never be subject to a GST tax, even though it may extend for multiple generations. Under Florida law, a Dynasty Trust could exist for up to 360 years; and certain other jurisdictions, such as Delaware, allow Dynasty Trusts to continue in perpetuity.

Lifetime gifts, including gifts to a Dynasty Trust, can be leveraged in a manner that testamentary transfers cannot. A gift to a Dynasty Trust followed by an installment sale of property to the Trust can freeze the transfer tax value of a greater amount of property and allow all post- transaction appreciation above the interest rate used in the installment sale to pass free of transfer tax for the benefit of the Dynasty Trust.

Finally, there are numerous other ways to make gifts to take advantage of the opportunity under the 2010 Tax Act. These other gifting possibilities include: (i) funding life insurance trusts to hold life insurance on your life; (ii) transferring interests in a personal residence through a Qualified Personal Residence Trust; and (iii) forgiving existing promissory notes.

Portability Does Not Remove Benefits of Credit Shelter Trusts

The portability provision for a predeceased spouse's unused exclusion amount does not take away the benefits of creating a credit shelter trust at the first spouse's death. Merely transferring the unused exclusion amount (without funding a credit shelter trust at the first death) could still result in significantly higher tax at the second spouse's death, as all appreciation between the death of the first spouse and the death of the second spouse will be subject to estate tax at the second spouse's death.

> For example, assume that the full $5,000,000 in Applicable Exclusion is available at the first spouse's death and the first spouse to die has at least that much in assets. Also assume that the surviving spouse has his or her own assets which are equal to or greater than the then available Applicable Exclusion at the time the surviving spouse dies. If the full Applicable Exclusion amount [$5,000,000] is funded into a credit shelter trust at the first spouse's death, then that credit shelter trust is completely excluded from the surviving spouse's estate. If instead the first spouse relies on the portability provision, his or her $5,000,000 Applicable Exclusion amount – plus any appreciation – is included in the surviving spouse's estate; but, only $5,000,000 of exclusion is available to offset the total amount of the exclusion asset value which is includable in the taxable estate of the surviving spouse. If the surviving spouse lived for an additional 10 years and the $5,000,000 exclusion amount assets from the first spouse appreciated to $10,000,000 (an approximate 7% rate of return), there would be an additional $1,750,000 in estate tax owed (assuming a 35% rate) by relying solely on portability of the unused exclusion amount compared to funding a credit shelter trust at the first spouse's death.

Furthermore, the portability provision only applies to estate tax exclusion, with the result that any unused GST Exemption of the first spouse to die is permanently lost. At a 35% GST tax rate, wasting $5,000,000 of GST exemption has a cost of $1,750,000 in immediate tax on generation-skipping transfers and additional future tax costs with respect to property that could have been placed into GST-exempt trusts lasting multiple generations. Additionally, a credit shelter trust could protect the assets from claims of the spouse's creditors, while an outright devise to the surviving spouse would provide no creditor protection. Portability also provides no control regarding the disposition of assets after the second death or during the life of the surviving spouse. However, under certain circumstances, where the combined value of property at the second spouse's death is not anticipated to result in an estate tax liability, portability of the exemption might be preferable for tax reasons because all of the combined property will be eligible for a basis step-up. There is no clear-cut rule that can be applied, and many factors need to be considered in determining the best course of action.

Finally, the portability provision is only certain to be part of the Tax Code in 2011 and 2012. There is no guarantee that the portability provision will be applicable at the time of the death of the surviving spouse, if the surviving spouse lives beyond 2012. Therefore, failing to plan properly in reliance on portability may ultimately backfire.

Uncertainty Remains for Periods After 2012

The estate, gift, and GST provisions of TRUIRJCA apply only in 2011 and 2012. Without further Congressional action, the estate, gift, and GST taxes revert to their pre-2001 levels in 2013: a $1,000,000 applicable exclusion amount and a 55% top tax rate (the GST Exemption would be approximately $1,360,000 - $1,000,000 – indexed for inflation). The status of the estate, gift, and GST tax levels beyond 2012 will likely be debated extensively and could depend on the outcome of the 2012 elections. Accordingly, the estate planning opportunities available in 2011 and 2012 might not be available after the end of 2012.

Additional Planning Opportunities for the Near Future

Prior to the 2010 Tax Act, it was thought that extension of lower tax rates and larger exclusion amounts would be accompanied by restrictions on the use of some popular estate planning strategies. Certain proposals restricted (i) the use of GRATs by requiring a minimum 10-year term and preventing use of GRATs with a zero remainder and (ii) the ability to use valuation discounts for closely held entities. The 2010 Tax Act did not contain any of these restrictions; so, GRATs and, under appropriate circumstances, valuation discounts remain available for planning under the 2010 Tax Act. However, how long these planning strategies will remain available continues to be uncertain.

Conclusion

We hope this summary of the estate, gift, and GST provisions of the 2010 Tax Act is helpful to you. Please feel free to access our website (www.gunster.com) for additional information. You will be happy to know that we are moving toward having our popular "Creative Wealth Planner" newsletter available by email. This periodical has updates and short articles which will give you quick and important insight into current estate planning developments and related laws, IRS rulings, and other issues, as they evolve. To ensure you can receive it by email, please email your name and preferred email address(es) to: Stalbot@gunster.com.

As always, please contact us at your convenience if you would like to explore any planning opportunities under the new law.
Sincerely,

Private Wealth Services Group
Gunster

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