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CLIENT ALERT

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July 11, 2012

2010 Tax Relief Act Tax Changes Set to Expire on December 31, 2012

The favorable estate, gift and generation-skipping transfer (GST) tax changes that were put in place by the 2010 Tax Relief Act are scheduled to expire on December 31 of this year. Through the end of 2012, the law provides that gift transfers may be made in the following extraordinary amounts without incurring gift taxes, assuming no prior use of gift tax exemption:

- For a single taxpayer, up to $5,120,000
- For a married taxpayer, up to $10,240,000

At year end, unless a new law is passed by Congress and signed into law by the President, the 2010 Tax Relief Act will sunset and the estate and gift tax exemption will plummet to $1 million, the GST exemption will fall to $1 million (with an inflation adjustment), and the top gift, estate and GST rates will spike from 35% to 55%.

A prediction of what Congress and the President may do or try to do about the exemption amounts and tax rates come January 1, 2013 would be guesswork.

For instance, in a February, 2011 Department of Treasury publication, the current Administration set forth budgetary proposals, including its desired changes to the federal estate, gift and GST provisions, which would restore the 2009 estate, gift and GST tax rules, providing for a $1 million gift tax exemption, a $3.5 million estate and GST exemption, and a top estate, gift and GST tax rate of 45% as of January 1, 2013. A variety of other proposals have also been introduced.

In light of the increased exemptions, those who are able to make substantial gifts of assets should take advantage of the wealth transfer opportunities now. Significant gifts may be made through a host of different methods, including:

Outright Gifts:

- Take advantage of the increased exemption by year end, while removing future appreciation from the estate.
- Valuation discounts for lack of marketability and minority interests may be available upon the gift of certain assets such as in closely-held entities.

Gifts in Trust, Including:

- Qualified Personal Residence Trusts (QPRTs). These trusts are a popular method for gift minded donors who may be concerned about an immediate loss of liquidity. By creating a QPRT, a donor can make a gift in trust, at a reduced gift tax cost, of a personal residence in exchange for its continued use rent-free for a term of years selected by the donor. At the expiration of the term, the residence passes at no additional gift tax cost to the selected beneficiaries. If the donor wishes to continue to occupy the residence after the expiration of the term, it must be rented from the beneficiaries.

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- Intentionally Defective Grantor Trusts (IDGTs). Assets gifted to an IDGT are removed from the donor's estate for gift and estate tax purposes, but the donor remains responsible for payment of income taxes which payments are, in effect, additional non-gift taxable transfers to the IDGT. In addition, establishment of an IDGT provides a vehicle for selling assets of the donor to the IDGT, without incurring a capital gain, in exchange for a promissory note. Any assets in the IDGT remaining after the Promissory Note is paid back to the donor are transferred to the beneficiaries free from federal gift or estate tax.

- Inter-Vivos Spousal Trusts. Spousal Trusts established during lifetime may take advantage of all or part of the gifting spouse's state or federal exemption amount, and remove the future appreciation of those assets from his or her estate. Such a trust may be structured to provide for discretionary distributions of the trust assets for the lifetime benefit of the donor's spouse or sprinkled among the donor's spouse and descendants, and then upon the death of the spouse, retained in further trust for the benefit of the donor's descendants.

- Multigenerational Trusts and Perpetual Dynasty Trusts. These trusts may be established to benefit children, grandchildren and beyond and may be funded by a husband and wife with up to $10,240,000 free of gift or GST tax (assuming no prior use of those exemptions). Once funded, the assets, and any appreciation thereon, will be free from further gift, estate or GST taxes.

- Grantor Retained Annuity Trusts (GRATs). A GRAT is a trust to which a donor irrevocably transfers assets in exchange for an annuity for a fixed term of years chosen by the donor. Upon expiration of the term, if the donor is living, any remaining trust assets pass to the beneficiaries free of gift tax. The low federal interest rates presently in effect enhance the effectiveness of GRATs as does the funding thereof with appreciating and/or discountable assets.

The inability of the federal government to forge a long term estate and gift tax policy over the last twelve years renders any prediction about what the federal government may or may not do to address estate, gift and GST tax law reform virtually impossible. Nonetheless, one element of relative certainty does exist -- the transfer tax rules which are in place for the rest of 2012 are favorable to taxpayers and those who can take advantage of the planning opportunities should do so. If you wish to explore the options described above, please contact an attorney so that there is sufficient time to analyze your specific circumstances and implement your goals.

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