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## Estate, Gift and Generation-Skipping Transfer Tax Developments under the 2010 Tax Relief Act

To our Friends and Colleagues:

The Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010, enacted on December 17, 2010 (the "Act"), made substantial changes to the federal estate tax, gift tax and generation-skipping transfer ("GST") tax and provides significant opportunities for estate planning for 2011, 2012 and beyond. The Act also made substantial changes to the estate and GST taxes applicable to estates of persons who died in 2010. This letter will outline the important changes made by the Act and some of the estate planning opportunities that may now be available.

### *Impact on 2010 Deaths*

For estates of persons who died in 2010, the Act reimposes the federal estate tax, with a \$5 million exemption, a 35% rate and a full step-up in basis for income tax purposes with respect to assets acquired from a deceased person's estate. However, the Act allows the executor of an estate of a person who died in 2010 to elect to have no federal estate tax apply; but, in such case, the inherited assets will not be eligible for a full step-up in basis. Instead carry-over or cost basis rules will apply, except that a surviving spouse may step-up up to \$3 million in basis of assets and all other heirs, in the aggregate, may step-up up to \$1.3 million in basis of assets.

Generally, executors of estates of decedents who died in 2010 where the estate is valued at less than \$5 million should not make the election out of the federal estate tax. Executors of 2010 decedents' estates where the estate is substantially in excess of \$5 million should generally make such election, and executors of 2010 decedents' estates valued somewhat above \$5 million will have to analyze the pros and cons of making such election on a case-by-case basis.

### *Estate, Gift and GST Tax Changes for 2011 and 2012*

The federal estate, gift and GST tax exemptions have been "reunified" beginning January 1, 2011, with a \$5 million exemption rate. This means that: (i) estates valued at \$5 million or less will have no federal estate tax to pay; (ii) persons may make gifts over their lifetimes of up to \$5 million without having to pay any federal gift tax; and (iii) persons may make generation-skipping transfers over their lifetimes of up to \$5 million without having to pay any generation-skipping transfer tax. Previously, the lifetime gift tax exemption was \$1 million. The estate, gift and GST tax rate applicable to transfers in excess of the \$5 million exemption has also been reduced to 35%. In addition, for the first time, there is now portability of the estate and gift tax exemptions between spouses. This means that, subject to certain technical rules, the estate of a surviving spouse may utilize up to \$5 million of a predeceased spouse's unused estate tax

exemption and a surviving spouse may utilize up to \$5 million of a predeceased spouse's gift tax exemption. However, unless Congress acts again, the portability of a predeceased spouse's unused estate tax exemption will apply only if the predeceased spouse dies in 2011 or 2012 and in 2011 or 2012 the surviving spouse either uses such exemption for gift tax purposes or dies.

The Act provides some significant opportunities for wealth transfer planning. For example, beginning in 2011, persons may now transfer up to \$5 million cumulatively to their children, grandchildren, other desired beneficiaries and/or trusts for their benefit without having to pay any federal gift tax. Persons who had previously fully utilized their \$1 million gift tax exemption can now give up to \$4 million more without having to pay federal gift tax. Married couples who both used their \$1 million exemptions can now transfer \$8 million more without federal gift tax. Assuming the gift transfers are structured properly, all post-transfer appreciation in the transferred assets will be removed from the donor's estate for estate tax purposes. The transfer tax savings advantages of making a large gift can be enhanced by making the gift to a so-called defective grantor trust, i.e., a trust the assets of which are removed from the donor's estate for estate tax purposes but the income of which is taxed to the donor for income tax purposes.

As noted above, beginning in 2011, individuals may now make generation-skipping transfers of up to \$5 million to their grandchildren, great-grandchildren or trusts for their benefit without subjecting the donor to generation-skipping tax. There is no portability of the unused GST exemption of a predeceased spouse.

It is also worthwhile to note that the Act did not make any changes to the Grantor Retained Annuity Trust ("GRAT") provisions of the tax law, although various proposals to do so had been considered by Congress. Therefore, as an additional wealth transfer measure, persons may wish to consider making transfers to one or more GRATs. Transfers to GRATs, installment sales of assets to a defective grantor trust, loans to family members and loans to a defective grantor trust are all means to transfer wealth to a younger generation; and these techniques tend to work well from an estate planning perspective in a low interest rate environment, as is currently the case.

#### *State Estate Tax Planning Considerations*

It is critical to note that the Act made no changes to State estate taxes. Thus, for example, persons living in New York, New Jersey and Connecticut are still subject to their respective State's estate tax laws. New York, New Jersey and Connecticut impose their own State estate taxes on estates in excess of \$1 million, \$675,000 and \$3.5 million, respectively. Thus, married couples whose joint estates are under \$10 million and unmarried persons whose estates are under \$5 million may wish to focus part of their estate planning on reducing their exposure to State estate taxes. One way to do this is to utilize a portion of one's \$5 million gift tax exemption during lifetime. For example, under current New York law, the amount of a deceased person's "adjusted taxable gifts," i.e., his or her cumulative gifts made during lifetime, are not taken into account in calculating New York estate taxes even though such gifts are taken into account for federal estate tax purposes. Thus, based upon the particular circumstances, the State estate tax savings of utilizing one's full \$5 million federal gift tax exemption can amount to as much as \$400,000.

*Planning for Married Couples*

Prior to the Act, in order for a husband and wife to fully utilize both of their estate tax exemptions, generally, each of them had to have assets in their separate names equal to the estate tax exemption amount, and they both had to have the proper estate tax exemption trust or estate tax exemption disposition provisions in their Wills. As a result of the Act, it is no longer necessary for *federal* estate tax purposes to divide assets between spouses or to have such provisions in the spouses' Wills. However, because the Act's estate tax exemption portability provisions do not apply for *State* purposes, it is still important for married couples who live in New York, New Jersey, Connecticut and other states with State estate taxes to continue to divide their assets between themselves and have the appropriate estate tax exemption provisions in their Wills.

*Sunset Provisions*

Unfortunately, the Act contains a "sunset" provision, which provides that the estate, gift and GST tax provisions will expire after December 31, 2012, unless further action is taken by Congress. Thus, in 2013, unless Congress acts again, the estate, gift and GST tax exemptions will revert to the prior law \$1 million exemption (indexed, however, for inflation since 1998) and the maximum tax rate will be 55%.

*Conclusion*

As can be discerned from the above, the Act provides significant opportunities for estate planning and wealth transfers, particularly for gifts made in 2011 and 2012. Because the gift and GST tax provisions are scheduled to sunset in 2013, acting on a timely basis is important. Further, because estate planning is so individual in nature, it is essential to consider your own personal circumstances in deciding how the Act's provisions apply to and can be best taken advantage of by you.

We would be pleased to meet with you to review your estate planning and to consider whether changes should be made to your estate plan. Please contact Steve Krass at extension 200 or [skrass@ksslaw.net](mailto:skrass@ksslaw.net) or Lee Snow at extension 230 or [lsnow@ksslaw.net](mailto:lsnow@ksslaw.net) to schedule an appointment.

Best wishes for a healthy and prosperous 2011.

KRASS, SNOW & SCHMUTTER, P.C.

To ensure compliance with requirements imposed by the Internal Revenue Service, we are required to inform you that any tax advice contained in this letter is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.