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MAJOR ESTATE, GIFT AND GENERATION SKIPPING TRANSFER TAX CHANGES UNDER NEW TAX LAW

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "new tax law"), signed by President Obama last Friday, extends the 2001 Bush tax cuts and makes significant changes to the Federal estate, gift and generation-skipping transfer ("GST") tax law for 2010, 2011 and 2012.

In short, the new tax law:

- Reinstates the estate tax for individuals dying during 2010 at a 35% tax rate and an exemption of $5 million, but gives these estates the option of avoiding estate tax entirely (*i.e.,* having the "old" law of no estate tax in 2010 apply) at a cost of giving up the income tax basis "step-up" that would otherwise accompany property received from a decedent.
- Retains the $1 million lifetime gift tax exemption at a 35% tax rate for gifts made during 2010 but raises that exemption to $5 million starting in 2011.
- Reinstates the GST tax with a $5 million exemption *and a tax rate of zero for 2010*. Starting in 2011, the GST tax rate will be set at 35%.
- Starting in 2011, the new tax law will allow "portability" of estate and gift tax exemptions between spouses – that is, a surviving spouse will be able to apply any unused portion of the estate and gift tax exemption of the deceased spouse to taxable transfers made by the survivor.
- Starting in 2012, the estate, gift and GST tax exemptions are all adjusted for inflation.

The new tax law will not change the amount of state estate taxes imposed on estates of individuals residing in states, such as New York, which have their own estate taxes and are "decoupled" from the Federal estate tax system. However, an available state death tax deduction for Federal estate tax purposes (which also is reinstated under the new tax law) will reduce the effective rate of state taxes.

The new tax law will "sunset" at the end of 2012. Without further legislation before then, the laws affecting estate, gift and generation-skipping transfers will revert to the law which was in effect before the Bush tax cuts were enacted in 2001 (*i.e.,* a 55% maximum estate, gift and GST tax rate and $1 million exemption).

The increase in exemptions and lower rates offer significant planning opportunities during the next two years by allowing individuals to make large lifetime gifts to beneficiaries of multiple generation levels at reduced or no tax cost. Such gifts can be further leveraged to remove even more assets from an individual's eventual estate through various sophisticated estate planning strategies.

In addition, until the end of 2010, there is a one-time opportunity to make GST gifts to or for the benefit of grandchildren or more remote descendants without using any GST exemption or paying any GST tax. This opportunity can be used to create new trusts for such descendants or make distributions to descendants from non-GST exempt trusts which – in any year but 2010 – would generate GST tax.

Finally, for individuals living in states like New York which have no gift tax but impose an estate tax (New York's estate tax exemption is a low $1 million), the ability to make lifetime gifts utilizing the increased Federal gift tax exemption under the new tax law could reduce overall estate taxes by leaving fewer assets subject to state estate taxes.

We are available to advise our clients in determining how the new tax law is relevant to their particular situation and to assess estate planning opportunities and strategies for significant transfer tax savings.

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