

Federal Gift, Estate and Generation-Skipping Transfer (“GST”) Tax Changes Arising From the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act Of 2010 (“TRA 2010”)

If you would like to receive more information about TRA 2010 or would like to discuss the impact of TRA 2010 upon your estate plan, please contact your Vorys estate planning attorney or one of the other attorneys in our Trusts, Estates, and Wealth Transfer practice area listed below:

Victor J. Ferguson
vjferguson@vorys.com
 614.464.6227

Suzanne R. Galyardt
srgalyardt@vorys.com
 614.464.5479

Ronald L. Rowland
rlrowland@vorys.com
 614.464.6392

David A. Swift
daswift@vorys.com
 614.464.8370

Mark E. Vannatta
mevannatta@vorys.com
 614.464.8295

David A. Groenke
dagroenke@vorys.com
 513.723.4017

Colleen B. Laux
cblaux@vorys.com
 513.723.4067

Emily S. Pan
espan@vorys.com
 513.723.4055

Michael G. Schwartz
mgschwartz@vorys.com
 513.723.4679

TRA 2010 was signed into law by President Obama on December 17, 2010. The enactment of TRA 2010 ended a year of confusion and uncertainty with respect to the continued status of the federal gift, estate and GST taxes (sometimes collectively referred to as the “federal transfer taxes”). The good news is that TRA 2010 included a number of taxpayer-friendly provisions from a federal transfer tax standpoint, including the following:

1. Increase in Tax Exemptions to \$5,000,000 – The gift tax, estate tax and GST tax exemptions were each increased by TRA 2010 to \$5,000,000 for years 2011 and 2012. Under prior law, the gift tax exemption was \$1,000,000 and, if TRA 2010 had not been enacted, the estate tax exemption would have been reduced to \$1,000,000 on January 1, 2011, and the GST tax exemption would have been reduced to approximately \$1,300,000 on January 1, 2011.
2. Reduced 35% Tax Rate – As a result of TRA 2010, the tax rate for gift, estate and GST tax purposes is reduced to 35% for 2011 and 2012. If TRA 2010 had not been enacted, the tax rate for such purposes would have been as high as 55%.
3. Portability of Estate Tax Exemption – For the first time, TRA 2010 provides that the unused portion of a decedent’s estate tax exemption may be transferred to his or her surviving spouse. This “portability” will allow a husband and wife to aggregate their gift and estate tax exemptions and pass up to \$10,000,000 to their beneficiaries free of gift and estate tax in 2011 or 2012. Although relying on the portability of a decedent spouse’s estate tax exemption may prove to be advantageous in certain situations, there are risks in such reliance: (i) There is no certainty that portability will be permitted for decedents dying after 2012 or that the portable exemption amount will remain the same; (ii) Portability could be lost if the surviving spouse remarries; (iii) Portability is not available for the GST tax exemption; (iv) A portability plan where all is left outright to the surviving spouse does not afford the protection from creditors and second spouses that would be provided by a trust arrangement; and (v) There is no portability for the Ohio estate tax exemption.

Changes May Be Only Temporary

The changes enacted by TRA 2010 are due to expire on December 31, 2012 unless Congressional action is taken before the end of 2012 to extend such provisions. If Congress fails to take any action, the federal gift, estate and GST tax laws

will revert to pre-2001 law beginning on January 1, 2013. The following chart illustrates important provisions of the federal transfer taxes as they stood in the years 2002 through 2010 and how they stand after TRA 2010:

	2002/2003	2004/2005	2006	2007/2008	2009	2010	2011/2012	2013 and beyond*
Estate Tax								
Exemption	1,000,000	1,500,000	2,000,000	2,000,000	3,500,000	0 or 5,000,000	5,000,000	1,000,000
Top tax rate	50%/49%	48%/47%	46%	45%	45%	0% or 35%	35%	55%
Gift Tax								
Exemption	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	5,000,000	1,000,000
Top tax rate	50%/49%	48%/47%	46%	45%	45%	35%	35%	55%
GST Tax								
Exemption	1,100,000	1,500,000	2,000,000	2,000,000	3,500,000	5,000,000	5,000,000	1,400,000 (est.)
Flat tax rate	50%/49%	48%/47%	46%	45%	45%	0%	35%	55%

*Assuming that no Congressional action is taken during 2011 or 2012 to extend the provisions of TRA 2010.

What Does This Mean?

1. Planning Opportunities – The increased gift and GST tax exemptions for 2011 and 2012 offer significant planning opportunities, including the ability to make gifts of substantial amounts of assets to children and grandchildren (outright or in trust) without incurring gift or GST tax. In addition, TRA 2010 did not eliminate or limit the viability of many popular estate planning techniques (including Grantor Retained Annuity Trusts).
2. Review of Current Estate Plans – We encourage all of our estate planning clients to (i) review their estate planning documents, (ii) determine the impact of the provisions of TRA 2010 on their documents, and (iii) consider whether changes should be made to their documents in light of these developments. In particular, clients who fall in one or more of the following categories are more likely to need revisions to their current estate planning documents:
 - (a) Clients With Current Estate Planning Documents That Contain Formula Provisions Based Upon the Amount of the Federal Estate Tax Exemption – As indicated by the chart above, the federal transfer tax exemption amounts have been a moving target for several years and may continue to fluctuate due to the two-year expiration date of the provisions of TRA 2010. A large number of estate planning documents (including so-called “A/B Trusts”) contain formula provisions based upon the amount of the federal estate tax exemption. With the federal estate tax exemption now at \$5,000,000 (at least for 2011 and 2012), a formula provision based upon the amount of the federal estate tax exemption could result in more assets than intended passing to the beneficiaries receiving the tax exempt amount.
 - (b) Clients With Current Estate Planning Documents That Contain Formula Provisions Based Upon the Amount of the Federal GST Tax Exemption – Some estate planning documents contain formula provisions based upon the amount of the federal GST tax exemption. In these cases, the increase in the GST tax exemption to \$5,000,000 could distort the estate plan and result in more assets than intended passing to one class of beneficiaries to the exclusion of other beneficiaries. For example, a trust agreement could contain a formula provision leaving an amount to grandchildren equal to the maximum GST tax exemption with the remainder of assets (if any) passing to children.
 - (c) Clients With Assets Significantly Less Than the Amount of the Current Federal Estate Tax Exemption – Many clients have A/B Trust arrangements that were prepared when the federal estate tax exemption was significantly lower than it is today. In some cases (after taking into consideration the temporary nature of the provisions of TRA 2010), it may now be possible to greatly simplify these estate planning documents.

- (d) Clients Who Have Remarried And Have Blended Families – Some clients may have estate planning documents which leave differing amounts to new spouses, step-children and biological children. Because such amounts are often driven by tax considerations, it is important that such documents be reexamined in light of TRA 2010 to insure that the asset distribution will be consistent with the client's intention.
- (e) Clients With Current Estate Planning Documents That Contain Charitable Bequests – Because charitable giving is often interrelated with tax planning, clients with estate planning documents that contain charitable bequests should reexamine their documents in light of TRA 2010 to determine if the charitable provisions are still appropriate.

IRS CIRCULAR 230 DISCLOSURE: In order to ensure compliance with requirements imposed by the U.S. Internal Revenue Service, we inform you that any federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and it cannot be used, by any taxpayer for the purpose of (i) avoiding penalties that may be imposed under the U.S. Internal Revenue Code or (ii) promoting, marketing, or recommending to another person, any transaction or other matter addressed herein.

This client alert is for general information purposes and should not be regarded as legal advice.