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Sweeping New Tax Legislation Signed Into Law

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The following letter was recently distributed to clients and friends of Cole Schotz:

Dear Clients and Friends:

On December 17, 2010, President Obama signed into law sweeping new tax legislation that makes significant changes to estate, gift and generation-skipping transfer ("GST") taxes. Not only may the new law have a dramatic impact on your existing estate plan, which we now strongly encourage you to review, it may also provide an excellent opportunity to implement additional planning that could benefit several generations of descendants.

In this regard, it is important to note that the new law is temporary – the favorable tax provisions sunset at the end of 2012, at which time Congress will either pass new legislation or allow the provisions of the 2001 tax law to take effect ($1 million exemption and a top estate and gift tax rate of 55%). Thus, it is critical for you to review your estate plan during this two year period to ensure you are maximizing your tax saving opportunities.

This letter contains a brief overview of the major changes to the federal estate, gift and GST tax system, all of which are effective January 1, 2011:

- The estate, gift and GST exemptions are $5 million per taxpayer and the tax rate is 35%. Prior to the suspension of estate and GST taxes in 2010, the estate and GST exemptions were capped at $3.5 million, the gift tax exemption was capped at $1 million and the top tax rate was 45%. The exemption amounts will be adjusted for inflation after 2011.
- The estate tax exemption for a deceased spouse is now "portable," meaning the surviving spouse can use the unused estate tax exemption of the "last deceased spouse." Thus, for example, if the first deceased spouse's exemption is left fully intact, the surviving spouse will be able to transfer during his or her lifetime or at death $10 million gift and estate tax free. Use of the last deceased spouse's exemption is not automatic – an election will need to be made on the last deceased spouse's federal estate tax return. In addition, the deceased spouse's GST exemption is not portable. What this all means is that portability planning is not simple, and proper thought and consideration needs to be given to this issue to ensure it is being handled correctly.
- The lifetime gift tax exemption increases from $1 million to $5 million (and $10 million per couple) so that the gift tax exemption is now unified with the estate tax exemption. This presents many planning opportunities for taxpayers to transfer significantly more wealth during their lifetimes without paying gift tax. For those taxpayers who have previously utilized their full $1 million lifetime gift exemptions, the new tax law permits an additional $4 million of lifetime gifting gift tax-free. The annual gift exclusion remains at $13,000 in 2011, or $26,000 per couple.
- There was concern that the new legislation would include restrictions on the use of (i) valuation discounts when transferring ownership interests in family entities as a part of a gift giving program and (ii) short term grantor retained annuity trusts ("GRATs"), a very effective technique to transfer assets without the imposition of gift tax. The new tax law does not contain either restriction. Thus, family entity planning, short term GRATs and sale transactions to trusts should be seriously considered, especially in

light of the increased exemption amounts, and the current low valuation and interest rate environment.

- If, unfortunately, someone died in 2010, the new legislation has provided two different approaches to utilize in administering 2010 estates. The default rule is that the estate tax regime applies at a 35% rate and a $5 million estate tax exemption. The executor can opt out of the estate tax regime and instead choose the carryover basis regime, meaning there will be no federal estate tax but the decedent's beneficiaries will not get a stepped-up basis in the assets inherited (subject to a limited right to increase the basis by $1.3 million for any beneficiaries and an additional $3.0 million for spouses).
- While significant changes were made to the federal transfer tax system, as discussed above, state estate taxes remain unchanged. Due to the greater disparity between the federal exemption amount ($5 million) and state exemption amounts (New Jersey –$675,000 and New York -$1 million), a larger (and potentially) unnecessary state estate would be triggered if your existing estate plan maximizes the federal estate tax exemption. While the federal exemption is now portable, state exemptions are not, so it will be even more important for estate plans to provide flexibility to enable the appropriate decisions to be made to maximize tax savings. Finally, for those taxpayers who travel to Florida and can make it their home, the new law magnifies even further the importance of reviewing the possibility of changing one's domicile from New Jersey or New York to Florida to avoid the imposition of state estate taxes.
- As mentioned above, the new tax is not permanent – it sunsets at the end of 2012. Due to the temporary nature of the new law, it may be prudent for taxpayers to take advantage of the additional $4 million of tax-free gifting that is available for the next two years. Not only will additional gifting take advantage of the larger lifetime gift exclusion amount, it will remove the future appreciation of the gifted asset out of the taxpayer's estate and potentially shift income to beneficiaries in lower income tax brackets.

We strongly recommend that you contact a member of our Tax, Trusts and Estate Department to review the effect of this change in law on your estate plan, whether or not we drafted your estate planning documents.

Together, we can determine what steps, if any, need to be taken to achieve your estate planning objectives and to maximize the amount of wealth that will pass to younger generations. A list of the members of this department is attached to this letter.

Best wishes for a happy and healthy New Year.

Very truly yours,

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