

Transfer Tax Update

Late in December, Congress finally addressed the estate tax uncertainty created by its failure to act since 2001 by giving us a two-year fix. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 turned out to be much more liberal in its benefits than was generally thought likely, and opens certain opportunities for estate planning over the next two years.

The transfer tax highlights of the Act are as follows:

-The estate and generation-skipping transfer tax (“GST”) exemptions, which were \$3.5 million in 2009, rose to \$5 million for 2011 and 2012.

-The gift tax exemption, which had been frozen at \$1 million since 2001, also rose to \$5 million for 2011 and 2012.

-The maximum estate, gift and GST rates, which had been 45% in 2009, dropped to 35% for 2011 and 2012.

-The full step-up for income tax basis at death was restored.

-If a spouse dies and does not use fully his or her estate tax exemption, that unused amount may be used by the surviving spouse at his or her death. There are several limitations on this, however, and it does not apply to unused GST exemption.

-Estates of decedents who died in 2010 may elect to use the law as it was in effect prior to the Act or the new rules in effect for 2011. This means that for estates of under \$5 million, the executor can elect into the 2011 system, pay no estate tax and also get a full step-up in basis for all of the estate’s assets. The Act is not otherwise retroactive for 2010.

· There was no GST on generation-skipping transfers made in 2010. For the most part, these would be gifts made directly to a grandchild or more remote descendant. This does not apply to “garden variety”-type transfers to such things as most irrevocable insurance trusts, which still require an allocation of GST

exemption for gifts made in 2010 if the donor wants the trust to remain exempt from GST tax.

-No “revenue enhancers” were included. Thus, grantor retained annuity trusts (“GRATs”) may continue to be created for as short as two years and minority and marketability discounts for family-owned closely-held businesses are still applicable for transfer tax purposes.

What does this mean? It means that much larger gifts can be made over the next two years without having to pay any gift tax out of pocket. In addition, those gifts, when coupled with other techniques that can allow an individual to leverage the gift tax exemption, may allow tens of millions of dollars to pass to future generations without transfer tax.

Early in January, Illinois reinstated its separate estate tax when it temporarily increased its income tax from 3% to 5%. That tax is levied on estates of all residents with estates in excess of \$2 million. (It can also affect estates of nonresidents who own real estate in Illinois.) The estate tax rate in Illinois ranges from 8% to 16%, so, even though it is deductible for federal estate tax purposes, it can have a significant negative impact on a decedent’s estate. Given the increased income tax and the reinstated estate tax, some Illinois residents may begin to explore the idea of changing residence to another state such as Florida that has no income or estate tax.

If you would like to discuss any of the issues raised in this Alert, please call us.

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