MORGAN AND DiSALVO, P.C.
attorneys at law

RICHARD M. MORGAN, Esq.
rmm@morgandisalvo.com

LORAINE M. DiSALVO, Esq.
ldisalvo@morgandisalvo.com

December 2010 Newsletter - You Need to Act Now if You Want to Take Advantage of Certain Year-End Estate & Tax Planning Opportunities!

by Richard M. Morgan & Loraine M. DiSalvo

As noted in the News Alert we sent out on December 20, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("2010 Tax Act") is now the law of the land, after having been signed by President Barack Obama on Friday, December 17, 2010. What does the 2010 Tax Act mean from an estate planning perspective? Do you need to do anything now or in the near future? The answers to these questions depend on a number of factors.

Most of our clients will do nothing, spend their time enjoying the holidays and consider the 2010 Tax Act next year. And, in fact, doing nothing may be the right answer for most of our clients. However, some people may want to take advantage of one or more of a few estate planning opportunities that will only be available for the rest of 2010. The purpose of this Newsletter is to describe these short-term, year-end-only planning opportunities, and let you consider whether they may be right for you. **Just remember: if you want to act on any of these planning ideas, you must act quickly - before January 1, 2011. Call us immediately if you have questions about the ideas discussed in this Newsletter or want to take action.**

I. Making Regular Gifts to Trusts Intended to Be Made GST Tax Exempt Through The Allocation of the Giver's GST Tax Exemption. Many of our clients make regular gifts to irrevocable trusts which are intended to be made GST tax exempt through allocations of the clients' GST tax exemptions. For 2010, we had been telling these clients to avoid making any such gifts to their trusts, since the lack of GST tax exemption under the rules which applied prior to the 2010 Tax Act created a number of possibly negative effects which could result from such gifts. However, now that the 2010 Tax Act has restored the GST tax exemption for 2010 (at the $5,000,000 level, subject to reductions for prior use of the GST tax exemption), clients who would have made these gifts can now do so for 2010. This can allow these clients to take advantage of their 2010 gift tax annual exclusions through gifts to their trusts, and to have the comfort of knowing that those trusts can still be kept GST tax exempt.

II. Roth IRA Conversions. Many of our clients have already considered with their financial advisors the potential benefit of converting an existing IRA (or qualified plan account) into a Roth IRA during 2010. However, the 2010 Tax Act affects one of the factors in this consideration, and those who elected not to convert may want to reconsider. This is the change: Prior to the 2010 Tax Act, many people expected income tax rates to rise for 2011 and 2012. Those who expected rates to rise may have planned not to take advantage of the ability to defer the income from a conversion in 2010 until tax years 2011 and 2012. However, since the 2010 Tax Act will now preserve the 2010 individual income tax rates for 2011 and 2012, the option to defer Roth conversion income to those years may now be more appealing. This option to defer Roth conversion income to future tax years will not exist for conversions done after December 31, 2010. Therefore, those who previously decided not to do a Roth conversion for 2010 based on an assumption that they would not want to defer the income may want to contact their financial advisor to reconsider their decision.

III. Interest Rate Sensitive Transactions. This issue is not related to the 2010 Tax Act, but it is time-sensitive. As we discussed in a prior newsletter, certain types of transactions, such as gifts to grantor-retained annuity trusts ("GRATs"), gifts to charitable lead annuity trusts ("CLATs"), and loans or sales to related parties, can use certain, federally-determined interest rates to help transfer assets to intended beneficiaries at a very low overall cost. These federally-determined interest rates, which include the Applicable Federal Rates that apply to related party transactions and the Section 7520 rate which applies to GRATs and CLATs, are currently at historical lows, but scheduled to rise again for transactions which take place in January 2011. (The Section 7520 rate for December 2010 is 1.8%, and many of the Applicable Federal Rates are even lower, but the IRS just notified us that the Section 7520 rate for transactions in January 2011 will be 2.4%.) Those who may want to take advantage of some of the lowest interest rates in history to help with their estate planning transactions need to act before the end of December 2010. (For a CLAT, you may have until the end of February 2011 to use the December 2010 rate, since for certain charitable transactions you are allowed to use the best rate available during the month of the transaction and the previous two months. However, you should ideally begin setting up the transaction as soon as possible.)

IV. Gifting to Grandchildren and Lower Generation Beneficiaries ("GST Gifting"). GST Gifting is one of the most beneficial windows of opportunity created by the 2010 Tax Act. While this type of gifting may not be appropriate for everyone, in the right situation the rules which apply for the remainder of 2010 create the possibility for passing tremendous benefits to grandchildren or other lower-generation beneficiaries. Prior to the 2010 Tax Act, there was no GST tax in effect for 2010. Under the 2010 Tax Act, the GST tax now applies during 2010, but at a 0% rate. In addition, a transfer which triggers GST tax at the 0% rate still operates to change the manner in which the GST tax applies to a trust created by that transfer in future years. The types of transfers which can take advantage of this low rate are as follows:

A. Direct Skip Gifts Made to Grandchildren or Lower Generation Beneficiaries, Either Outright or in Trust. In the GST tax world, a gift which benefits only one or more "skip persons" is known as a "direct skip." "Skip persons" include grandchildren, great-nieces, great-nephews, great-grandchildren, and similar family members, as well as any unrelated parties who, based on their ages, are determined to be two generations or more below the maker of the gift. A direct skip is a GST taxable event to the extent that the GST tax annual exclusion does not apply to it (the GST tax annual exclusion applies to a more limited range of gifts than the gift tax annual exclusion does, so be sure to get good advice regarding gifts you expect to be non-taxable). For 2010, taxable direct skips will be taxed at the 0% rate. This allows a significant opportunity to make gifts to those skip persons who may be desired beneficiaries under your estate planning.

A direct skip can be as simple as an outright gift to an adult grandchild. However, for a gift to a trust to qualify as a direct skip gift, only skip persons can be beneficiaries of the trust at the time of the gift. In most cases, the typical, irrevocable, Family Gifting Trust will **not** qualify as a direct skip trust, since both non-skip persons, such as children, are likely to be beneficiaries as well as the grandchildren or other skip persons. Therefore, people who want to make a direct skip gift through a trust may also need to create the trust before making the gift for 2010. In addition to taking advantage of the 0% tax rate for 2010, a gift to a direct skip trust has the added benefit of changing the deemed "transferor" of the trust for future GST tax purposes, so that the trust will be treated for GST tax purposes as if it were created by a person only one generation above the highest level skip person beneficiaries. This means a direct skip trust created for grandchildren, which is a GST taxable transfer at creation (at the 0% rate if done in 2010), will be treated as if it were created by the creator's child for future GST tax purposes. That in turn allows distributions to or for the benefit of the grandchildren after the trust's creation to be free of GST taxes (distributions to great-grandchildren, however, would be subject to potential GST taxes). It may also be possible to have older beneficiaries added into the trust at some future time after its creation, which could allow the trust to be even more flexible and beneficial for the family.

In order to qualify for the 0% GST tax rate during 2010, the direct skip gift must be subject to GST tax. This will mean that the gift maker will need to file a gift tax return (IRS Form 709) for 2010, and elect out of having his or her GST tax exemption automatically allocated to the gift. In addition, to the extent that the gift tax annual exclusion does not apply to the gift, the gift will also be considered a taxable gift for gift tax purposes. If the gift maker's total lifetime taxable gifts exceeds his or her available gift tax exemption (which remains at $1,000,000 for 2010), then he or she will not only have to file a gift tax return, but will have to pay gift tax for 2010.

Paying gift taxes can be a good thing in some situations. However, the potential gift tax, along with other factors, should be carefully considered before you make any direct skip gifts. Very wealthy people should strongly consider paying gift tax during 2010. For example, a wealthy individual (who will likely still owe significant estate taxes even with a $5,000,000 estate tax exemption) may want to transfer $10,000,000 to a direct skip trust which will benefit his or her family for multiple generations. The number of generations that can avoid paying estate or GST tax on these assets will depend on the generation level of the current beneficiaries when the gift is made to the trust. If this gift is made during 2010, it will be subject to a GST tax rate of 0%, and to a historically low gift tax rate of 35%. The gift tax rate can effectively be lowered to as little as 26%, if the giver lives more than 3 years after the gift date, due to differences in the way the estate and gift taxes are calculated and the ability to remove the gift taxes paid from one's taxable estate for estate tax purposes. By making the $10,000,000 gift in 2010 instead of 2011, the giver can save approximately $960,000 in taxes. The gift and GST tax exemptions will increase to $5,000,000 in 2011; but the benefits of those exemptions do not reduce the benefits potentially available through making large taxable gifts during 2010.

B. Planning Using Taxable Distributions and Taxable Terminations. For those who have existing, non-GST tax exempt, irrevocable trusts, this ability to create a GST tax at the 0% rate during 2010 offers a way to reduce their trust's exposure to GST taxes in the future. A non-GST exempt trust which has non-skip beneficiaries, and thus has not previously been subject to GST tax, will create a GST tax in two situations: (1) upon the termination of the last interest held by a non-skip person beneficiary (such as that beneficiary's death), or (2) upon the distribution of assets from the trust to or for the benefit of a skip person in a way which does not qualify for any exception from the GST tax. The first situation creates a "taxable termination," which causes a GST tax with regard to all of the trust's assets. The second situation creates a "taxable distribution," which subjects the distributed assets to GST tax.

The Trustee of a non-GST tax exempt trust can use distributions to skip person beneficiaries to remove assets from the trust during 2010, at the 0% rate. In addition, in some situations, it may be possible for some part or all of the trust to be terminated and distributed to the beneficiaries, or even moved to a new trust which does not provide for non-skip person beneficiaries, triggering a GST tax at 0% with regard to the entire portion distributed to or to a trust for skip persons. Incurring the GST tax in this way at the 0% rate can shelter the trust from future GST taxes at much higher rates.

For those who are interested in any of the planning techniques discussed in this Newsletter, time is rapidly running out. Please call us immediately at (678) 720-0750 if you want to discuss these techniques.

Whatever you decide to do, we hope you the rest of your holiday season is safe and enjoyable, and we wish you a Happy New Year.