

OBAMA TAX SUMMARY — DECEMBER 7, 2010

*The estate tax legislation environment is rapidly changing with year-end approaching. Below is a summary of the most recent proposed Obama tax deal. **This deal has not been passed or enacted as of December 7, 2010.** However, it provides valuable insight as to how the estate and wealth transfer planning environment may change for 2011 and beyond.*

Bush tax cuts

Obama administration has struck a deal with Republicans to set estate tax rate at 35% for two years with an exemption of \$5 million. This has not passed. If no legislation has passed by year-end, then January 1st, 2011, the exemption is \$1 million with a 55% tax rate.

Estate Exemption Amount

\$5 million for two years in Obama deal; if deal does not pass, \$1 million effective January 1st, 2011.

Estate Tax Rate

35% for two years in Obama deal; if deal does not pass, 55% effective January 1st, 2011.

Gift Tax Exemption Amount

Not addressed in Obama deal; set to stay at \$1 million effective January 1st, 2011.

Gift Tax Rate

Not addressed in Obama deal; set to increase from 35% to 55% effective January 1st, 2011.

GST Exemption Amount

Not addressed in Obama deal. No GST exemption current exists as there is no GST tax. GST exemption will be \$1 million (indexed for inflation approximately 1.36 million) effective January 1st, 2011.

GST Tax Rate

Not specifically addressed in Obama deal. Historically, GST tax rate is equal to maximum estate tax rate, which is currently 0% but will increase to 55% effective January 1st, 2011.

Bush tax cuts (income taxes)

Obama administration has struck a deal with Republicans to extend Bush income tax cuts for two years, and reduce payroll taxes for one year. This has not passed. If no legislation has passed by year-end, then January 1st, 2011, the top ordinary income tax rate will increase from 35% to 39.6%

Top Ordinary Income Tax Rate

35% for two years in Obama deal; if deal does not pass, 39.6% effective January 1st, 2011.

Long Term Capital Gains

15% for two years in Obama deal; if deal does not pass, 20% effective January 1st, 2011.

Dividends

15% for two years in Obama deal; if deal does not pass, 39.6% effective January 1st, 2011.

Alternative minimum tax

Patch proposed under Obama deal that would “prevent many taxpayers from being subject to this alternative tax regime;” details not clear.

Payroll tax

Reduction of Social Security tax from 6.2% to 4.2% for one year proposed under Obama deal; if deal does not pass, payroll taxes will remain unchanged.

ESTATE EXEMPTION AMOUNT & TAX RATE

	2008	2009	2010	OBAMA DEAL 2011	NO DEAL 2011
EXEMPTION	\$2M	\$3.5M	\$0	\$5M	\$1M
TAX RATE	45%	35%	0	35%	55%

Reunification of estate and gift tax exemption amounts. Prior to the Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRAA), the estate and gift tax exemption amounts were unified at \$1M. Under the unified system, a taxpayer could transfer \$1M during life or at death free of estate or gift tax. EGTRAA changed that result with different estate and gift tax exemption amounts. For example, in 2009 the estate tax exemption amount was \$3.5M while the gift tax exemption amount was \$1M. In other words, in 2009 a taxpayer could transfer only \$1M during life free of gift tax, while they could transfer \$3.5M at death free of estate tax.¹

Reunification of the estate and gift tax exemption amounts likely will provide significant lifetime planning opportunities. Currently, the gift tax exemption amount is \$1M. Assuming the estate and gift tax exemption amounts are reunified at \$5M, an additional \$4M could be transferred by the taxpayer during life without incurring gift tax. The additional \$4M could be leveraged to support a \$40M installment sale of assets to a grantor trust. A portion of the income earned on the assets sold in the installment sale is used to service the installment sale note payments and fund life insurance. Reunification facilitates significantly larger installment sales which can fund life insurance premiums.

Reunification planning opportunities. Reunification will provide significant lifetime wealth transfer planning opportunities for your client to reduce their taxable estate, shift wealth to future generations, and acquire a needed life insurance death benefit outside their estate with minimal or no transfer tax cost.

Examples include:

- Increase gifts of cash, in trust or outright
- Increase gifts of assets subject to valuation discounts, in trust or outright
- Leverage increased gifts in trust with installment sales to grantor trusts
- Facilitate transfer of individually owned policies that were acquired to capture current underwriting pending resolution of estate/GST tax uncertainty outside client's estate with minimal or no transfer tax cost
- Provides client additional flexibility with annual exclusion planning by decreasing the reliance on annual exclusion gifts to fund ILITs

Portability. Historically, estate tax exemptions are, by nature, individual and "use it or lose it." As a result, married couples were required to utilize estate tax planning (e.g. bypass trust aka credit shelter trust) to capture each spouse's estate tax exemption amount at the first death. Portability would permit a surviving spouse to use the estate tax exemption amount that remained unused from his or her deceased spouse. From an estate tax perspective only, this provides a simpler approach than bypass trust planning.

¹ Gifts made during life reduce the estate tax exemption amount. For example, if the estate tax exemption amount was \$3.5M while the gift tax exemption amount was \$1M and the taxpayer transferred \$1M during life, the taxpayer's estate tax exemption amount would be reduced to \$2.5M.