



December 21, 2010

WEALTH TRANSFER PLANNING OPPORTUNITIES UNDER THE NEW TAX LAWS

On December 17, 2010, President Obama signed the “Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010” (the “Act”). We have included below our prior summary of the notable transfer tax provisions of the Act, which have not changed since the introduction of this legislation. In addition, we have highlighted certain estate planning opportunities that you may wish to consider based on these new tax laws.

Transfer Tax Provisions

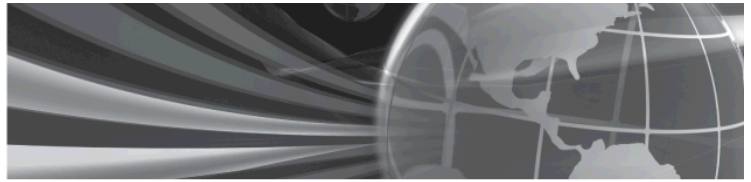
The Act implements the following provisions for the estate, gift, and generation-skipping transfer (“GST”) taxes (collectively, “transfer taxes”) *through December 31, 2012 only*. Note, however, that *the effective dates of certain provisions vary and may impact year-end tax planning*.

Estate Tax: The Act retroactively reinstates the federal estate tax as of January 1, 2010 at a maximum federal estate tax rate of 35% and an estate tax exemption of \$5 million.

- *Special Election*. Estates of decedents dying after December 31, 2009 and before January 1, 2011 may elect which federal estate tax laws they wish to apply:
 - The federal estate tax laws in effect prior to the Act (*i.e.*, no federal estate tax and a carry-over income tax basis for inherited assets “**carryover basis regime**”), or
 - The federal estate tax laws enacted under the Act.

GST Tax: The Act retroactively reinstates the federal GST tax on generation-skipping transfers (*e.g.*, transfers to grandchildren and more remote descendants and/or trusts for their benefit) as of January 1, 2010 and provides a \$5 million GST tax exemption.

- *0% in 2010*. For 2010 only, the GST tax will apply at a flat rate of 0%.
- *35% after 2010*. For generation-skipping transfers after 2010, the GST tax applies at a flat rate of 35%.
- *Estate Election Does Not Impact GST Application*. Even if a decedent’s estate elects to apply the carryover basis regime for estate tax purposes, the decedent still will be deemed a “transferor” of property for purposes of determining whether GST taxes apply to property transfers at death.



Gift Tax: The Act does not significantly impact the federal gift tax laws for 2010.

- *2010.* The maximum federal gift tax rate is 35% and the gift tax exemption is \$1 million.
- *After 2010.* The maximum gift tax rate remains 35%, but the *exemption increases to \$5 million.*

Exemption Reunification and Adjustments. As of January 1, 2011, the Act (1) reunifies the federal estate and gift tax exemptions at \$5 million, (2) ties the federal GST tax exemption to the maximum federal estate tax exemption, and (3) annually adjusts these exemption amounts for inflation beginning January 1, 2012.

Gift/Estate Tax Exemption Portability. The executor of a decedent dying after December 31, 2010 can elect to provide his or her surviving spouse with his or her “deceased spousal unused exclusion amount” (*i.e.*, the deceased spouse’s remaining unified exemption amount after reduction for his or her taxable estate). The deceased spouse’s executor must file a timely estate tax return indicating the deceased spousal unused exclusion amount and electing to make it available to the surviving spouse. The surviving spouse can only use the unused exclusion amount of his or her “last such deceased spouse,” to prevent the accumulation of the unused exemptions of multiple spouses. Portability between spouses does not apply to the deceased spouse’s GST tax exemption.

Filing Extensions.

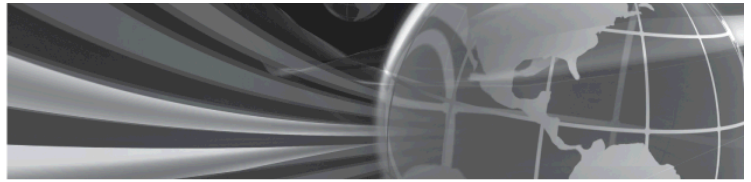
- *Estate Tax.* Estates of decedents dying after December 31, 2009 and before enactment of the Act have nine months from the date of enactment (December 17, 2010) to file any required federal estate tax returns, to pay any federal estate tax, and/or to have a beneficiary make a qualified disclaimer of any property interest passing to him/her by reason of the decedent’s death.
- *GST Tax.* The Act provides a nine-month period from enactment to file any GST tax return required for a generation-skipping transfer occurring after December 31, 2009 and before the Act’s date of enactment.

Sunset. The Act’s transfer tax provisions will sunset *after December 31, 2012*, and the Internal Revenue Code will apply as if the amended provisions “had never been enacted.”

Planning Opportunities

Opportunities for Wealth Transfers. The increased gift and GST tax exemptions provide significant opportunities for the lifetime transfer of wealth to future generations, particularly through the use of long-term or dynasty trusts that can protect the assets from future transfer taxes. Fully using these exemptions during life can substantially reduce an individual’s future estate tax exposure.

- *Gifts.* By making a gift, an individual (a “**donor**”) transfers the asset’s value out of his or her taxable estate. As an added benefit, the donor shifts all potential appreciation in the asset to the recipient at no additional transfer tax cost. The substantially higher federal gift and GST tax exemptions allow individuals to make significant gifts without having to pay gift or GST taxes.
- *Installment Sales to Grantor Trusts.* In this popular planning technique, an individual sells an asset to a grantor trust in exchange for a promissory note bearing interest at the Applicable Federal Rate (“**AFR**”). If the asset sold appreciates at a rate higher than the AFR, the seller has successfully transferred wealth, transfer tax-free, to the trust. Generally, an initial gift, often equal



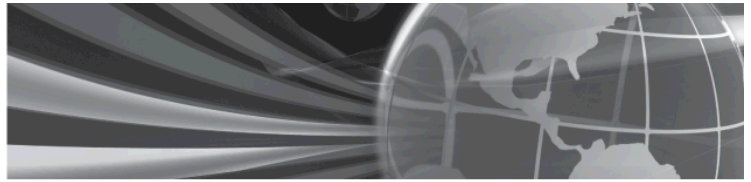
to 10% of the value of the asset sold, is required to “seed” the trust, in order to show that it will be able to meet its obligations under the note. The new, higher gift and GST tax exemptions should facilitate larger “seed” gifts, larger sale transaction, and thus larger, tax-free wealth transfers. In addition, the current, historically low AFRs increase the chances of a positive wealth transfer for this technique, creating an ideal environment for this type of planning.

Planning with Life Insurance. The Act provides clarification on several insurance planning issues and provides unique opportunities to leverage the benefits of the increased gift and GST tax exemptions through life insurance acquisition.

- *GST Tax Allocation for ILIT Contributions.* The retroactive enactment of the GST tax laws, including the ability to allocate GST tax exemption to transfers and the availability of a \$5 million GST tax exemption, allows 2010 generation-skipping transfers to irrevocable, GST-exempt trusts to be made on a GST-exempt basis. This result is of particular benefit to individuals who made gifts to such trusts in 2010, including gifts to irrevocable life insurance trusts (“**ILITs**”) in order to enable the payment of insurance premiums. These individuals should allocate GST tax exemption to the 2010 transfers as needed to preserve the GST-exempt status of their trusts.

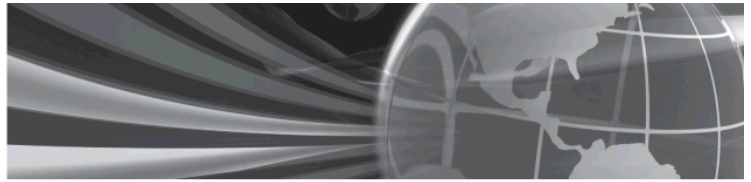
Individuals who made loans to their trusts or ILITs in 2010 in order to avoid the GST issues may want to unwind/forgive those loans prior to year-end, now that they have GST tax exemption available for allocation. In addition, individuals who did not make 2010 contributions to their ILITs may want to do so before year-end in order to use any of their remaining annual exclusions from gift tax. If not used in 2010, these annual exclusions are effectively “lost.”

- *Significant Leverage Opportunity.* Using the higher gift and GST tax exemptions to acquire life insurance can produce a multiplier effect in wealth transfer planning. Typically, relatively small premiums can generate disproportionately large death benefits. Further, the death benefits generally are paid on an income tax-free basis and also may avoid estate and GST taxes if the policy is held through a properly structured ILIT. These features make life insurance investment performance hard to replicate with other assets, particularly in the current low interest rate environment. Thus, incorporating life insurance into a wealth transfer planning strategy offers several benefits over funding it solely with investment assets.
- *Premium Funding.* The increased gift and GST tax exemptions will make it easier for many individuals to fund ILITs with the amounts needed to cover insurance premiums and may lessen the need to implement private split-dollar arrangements, loans, and other complex planning techniques to fund such premiums on a transfer tax-efficient basis.
 - As noted above, individuals can leverage the increased exemption amounts by making large lump-sum contributions to ILITs to pre-fund current or future premiums. The immediate availability of significant funds for premiums may increase the popularity of single-premium life insurance policies or modified endowment contracts, which may jump-start growth within the policy. Premium deposit accounts may also become an attractive feature.
 - Individuals with existing split-dollar funding arrangements may want to use their gift and GST tax exemptions to pay-off or exit these strategies while the increased exemptions remain available.



GST Tax Planning. As noted, the Act retroactively reinstates the GST tax laws and a \$5 million exemption effective as of January 1, 2010. Thus, 2010 generation-skipping transfers will still be subject to the GST tax provisions of the Code but at a 0% GST tax rate.

- *2010 Planning Options.* Although limited time remains, individuals may wish to consider the following planning options for 2010.
 - Direct Skip Gifts. These are gifts made to grandchildren, more remote descendants, or individuals more than 37½ years younger than the donor or to trusts that solely benefit such individuals (“**skip persons**”).
 - **For 2010 only**, direct skip gifts will not incur GST tax and will be subject to a maximum gift tax of 35% only after exhaustion of the current \$1 million gift tax exemption. Such gifts will not require the allocation of GST exemption to avoid a GST tax liability, because the applicable GST tax rate will be 0%.
 - Direct skip gifts may be made outright or in trust, subject to the following:
 - The trust should not initially name children as beneficiaries because transfers to that trust will not constitute direct skip gifts.
 - The trust should initially benefit only one generation of skip persons (*e.g.*, only grandchildren or only great-grandchildren). A transfer to a trust created for the benefit of both grandchildren and great-grandchildren will still qualify as a direct skip, and subsequent distributions from the trust to grandchildren will not be taxed as generation-skipping transfers. However, distributions to great-grandchildren will be subject to GST tax.
 - The trust may allow for the later addition of other beneficiaries (such as children or other descendants), while still avoiding multiple layers of GST tax.
 - For example, assume a donor creates a trust for the benefit of only great-grandchildren. Children and grandchildren are later added as trust beneficiaries. Generally, no GST tax should apply to any of the trust distributions to children, grandchildren, or great-grandchildren, because none of them will be deemed skip persons relative to the donor.
 - The trust may want to wait several (3-5) years to add additional beneficiaries. The IRS also could take action in the interim to prevent such additions to the class of trust beneficiaries.
 - Direct skip gifts made in 2010 that exceed an individual's remaining federal gift tax exemption (currently \$1 million) will still incur federal gift tax at a maximum rate of 35%. Accordingly, the benefits of making direct skip gifts prior to year-end will likely be greatest for those individuals who plan to undertake a significant gifting program in the next few years in excess of the \$5 million gift tax exemption.

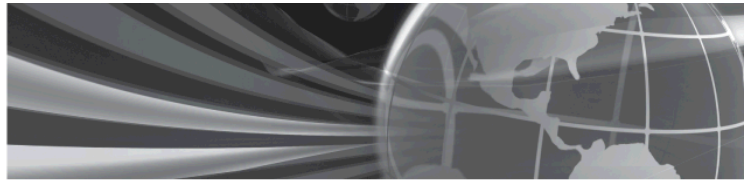


- 2010 Contributions to GST-Exempt Trusts. Individuals making 2010 generation-skipping transfers to trusts that will benefit multiple generations or that do not qualify as direct skips should allocate GST exemption to those transfers, even if they would not otherwise generate a GST tax. Without such an allocation, the trust's receipt of non-GST exempt property may adversely impact its GST tax-exempt status, causing subsequent distributions from that trust to incur a GST tax.
- Planning for Existing Trusts. In 2010, existing, non-exempt trusts can make taxable distributions to skip persons without incurring a GST tax liability.
 - Outright distributions, however, may not be preferred, particularly if they will be made to minors or if creditor protection is needed or desired.
 - It may be possible for the trustee of the existing trust to make such distributions to a new trust for the benefit of the skip beneficiaries, if the existing trust meets various requirements, including the following:
 - The existing trust gives the trustee significant discretionary powers, including with regard to distributions and invasions of trust principal.
 - The existing trust is created in one of 11 states with a "decanting" statute (Alaska, Arizona, Delaware, Florida, Indiana, Nevada, New Hampshire, New York, North Carolina, South Dakota, and Tennessee). Alternatively, the existing trust could attempt to take advantage of Alaska's decanting statute by appointing an Alaskan co-trustee to administer the trust. This statute's requirements and the effectiveness of this "decanting," however, should be reviewed carefully prior to any implementation.

Estate Planning with Portability. Portability between spouses of the reunified gift and estate tax exemptions provides significant protection against the waste of one spouse's exemption due to improper planning or an imbalanced division of assets between spouses. So-called credit shelter or bypass-type trusts, which are typically designed to hold a predeceasing spouse's estate tax exemption, should still be considered for estate planning purposes, since they protect the appreciation in any trust assets from future estate tax and provide creditor protection to the predeceased spouse's beneficiaries. If a surviving spouse receives any of his or her last deceased spouse's remaining exemption, however, he or she can apply it to lifetime wealth transfers.

Limited Window of Opportunity. The Act only **temporarily reduces** the number of families currently affected by the transfer tax system. With concerns over the growing federal deficit, it is unlikely that more permanent tax legislation can sustain all the favorable terms of the Act, including those related to transfer taxes. In addition, while the Act did not include any provisions to offset the cost of the new legislation, the 10-year minimum term for grantor retained annuity trusts ("GRATs") was a popular "pay-for" option with Congress and could still be passed in the short-term. **Accordingly, individuals, even those with limited transfer tax exposure under the Act, should consider planning now before the window of opportunity closes, particularly for those considering GRATs.**

Given these recent and dramatic tax law changes, you may wish to review how these new laws impact your current and future estate planning needs and goals. We are available to discuss these issues and opportunities with you and to help you craft planning solutions that take maximum advantage of this unique tax environment.



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