



**RETHINKING WEALTH TRANSFER, PART 1:
IMMEDIATE PLANNING CONSIDERATIONS FOR 2010**

A Tax
Department
Publication

Less than two weeks ago, President Barack Obama and Republican Congressional leadership struck an unprecedented—and fragile—two-year tax cut compromise. Last night, that compromise comfortably survived a final vote in the House of Representatives, settling major aspects of the tax law until January 1, 2013.

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Dec. 17,
2010

	2009		2010		2011 - 2012		2013	
Tax	Exemption	Rate	Exemption	Rate	Exemption	Rate	Exemption	Rate
Gift	\$1M	45%	\$1M	35%	\$5M	35%	\$1M (?)	55% (?)
Estate	\$3.5M	45%	\$5M*	35%*	\$5M	35%	\$1M (?)	55% (?)
GST	\$3.5M	45%	\$5M	0%	\$5M	35%	\$1M** (?)	55% (?)

*Executors of 2010 decedents can also elect into the "no estate tax/modified carryover basis" regime.
**Indexed for inflation

Because agreed-upon tax rates and exemptions expire at the end of 2012, taxes may be a significant issue in the 2012 elections. As noted above, absent further Congressional action, tax rates would rise—and exemptions plummet—come 2013. Sound familiar?

For those with significant assets, rethinking wealth transfer is a must. To help you begin this process, we begin below with some critical planning considerations for 2010.

Gifts to grandchildren in 2010.

Gifts to grandchildren are generally subject to both the gift tax and the generation-skipping transfer tax.

By setting the generation-skipping transfer tax rate at **zero** for 2010, the new law may greatly favor those who make properly structured gifts to grandchildren, grandnephews, grandnieces and other “skip persons” **before year-end**. No generation-skipping transfer tax will be imposed on these gifts. Equally important, you and your advisor can choose among several modes of gifting, including outright transfers; transfers to Uniform Transfers to Minors Accounts; transfers to Section 529 plans; and properly structured transfers in trust.

As is generally the case with taxes, factoring in your particular circumstances is critical, as in some cases it may be more beneficial to gift in 2011 instead of 2010. You and your advisors will need to consider your gift tax liability, remembering that next year

- the gift tax exemption and the generation-skipping tax exemption will both be \$5 million.

Example #1. Helen is a widow with three grandchildren. She has not used any of her \$1 million gift tax exemption prior to 2010. If she makes a properly structured \$1 million transfer to grandchildren in 2010, Helen’s tax liability will be:

Gift tax liability: \$0
(covered by unused \$1 million gift tax exemption)
Generation-skipping transfer (“GST”) tax liability: \$0
(0% GST tax rate in 2010)

Example #2: Same facts as in Example #1, except that, in 2009, Helen used all of her \$1 million gift tax exemption. If she makes a properly structured \$1 million transfer to her grandchildren in 2010, her tax liability will be:

Gift tax: \$350,000
(35% gift tax rate in 2010 on lifetime transfers in excess of \$1 million)
GST tax: \$0.
(0% GST tax rate in 2010)

Example #3: Same facts as in Example #2, except that Helen waits to make her gift until 2011, when the gift and generation-skipping tax exemption are both \$5 million. Assume she has previously used none of her generation-skipping tax exemption. If Helen makes a properly structured \$1 million transfer to grandchildren in 2011, Helen’s tax liability will be:

Gift tax liability: \$0
(covered by unused \$4 million gift tax exemption)
GST tax liability: \$0
(covered by unused \$5 million GST tax exemption)

Bottomline: This is an area that requires skillful planning and careful consideration of the facts. **If you are considering a substantial transfer to grandchildren at year-end, contact your estate-planning attorney (and your Northern Trust relationship manager) immediately.**

Generation-skipping distributions from (and terminations of) non-exempt generation skipping trusts in 2010.

The potential for a retroactive reinstatement of the generation-skipping tax threw a large shadow over tax planning this year. Today, the new tax act dispels this threat. As a result, there is a very narrow window of opportunity to make tax-free generation-skipping transfers from a limited number of trusts that are not themselves exempt from generation-skipping transfer tax. (See prior edition of [Tax News You Can Use](#), dated [November 2, 2010](#)).

If fiduciary standards and the terms of the trust permit, “skip persons” may receive discretionary distributions from these trusts tax-free in 2010. **Please let your relationship manager know immediately if you are a beneficiary who would like to request such a distribution.** The distribution must be received by year-end in order to take advantage of the zero generation-skipping transfer tax rate for 2010.

In some situations, independent action by a non-skip person in 2010 (e.g. by disclaimer or exercise of a limited power of appointment) can result in part or all of the trust distributing to skip persons without generation-skipping tax consequences. Keep in mind, however, that these actions may have substantial gift and/or estate tax consequences for the non-skip person. Timing will also be critical. The relevant documents (e.g. the document exercising the limited power of appointment or making the disclaimer) must be drafted by your counsel, executed by you and delivered to the trustee—all before year-end—in order to avoid generation-skipping transfer tax. Depending on the facts, the resulting distributions from the trust may need to be made before year-end as well. **Please let your relationship manager know immediately if you are considering making a disclaimer or exercising a limited power of appointment with respect to a non-exempt generation-skipping trust in 2010.**

Gifts to children and other non-skip persons in 2010.

Earlier this year, we faced the very real possibility of a 55 percent gift tax rate and \$1 million gift tax exemption for 2011. That environment created a planning opportunity for clients who had already used all of their \$1 million gift tax exemption: making **taxable** gifts this year in order to avoid a potential 55 percent gift tax rate in 2011.

Now, with the gift tax exemption increasing to \$5 million for 2011 and 2012—and the gift tax rate remaining at 35% for those years, the rationale for racing to incur gift tax before year-end has generally disappeared. Instead, we recommend that you begin talking with your estate-planning attorney now about how best to use the extra \$4 million in gift tax exemption available for 2011 and 2012.

Also keep in mind that \$13,000 annual exclusion gifts—which are not subject to gift tax—as well as the exclusion for direct payments of tuition and medical expense—are available both in 2010 and under the new law.

Charitable contributions in 2010

Some clients, anticipating higher income tax rates in 2011, have deferred substantial charitable contributions. Now these individuals need to take account of the income tax provisions of the new act, which continue the top 35 percent income tax rate into 2011 and 2012. Best advice: consult with your accountant before year-end. Given the annual limits on the income tax charitable deduction, it may be advantageous to accelerate part or all of your gifts into 2010. Remember, too, the old rule about accelerating deductions into the current year, all else being equal.



In addition to preserving low income tax rates, the new act extends—for 2010 and 2011 only-- two special charitable provisions:

- the \$100,000 IRA charitable rollover available for those 70 ½ and older; and
- the enhanced charitable deduction for qualified conservation contributions.

Those 70 ½ and older who would like to make a tax-free distribution of up to \$100,000 from their Traditional IRA to a qualified charity in 2010 should contact their relationship manager immediately. Note that the package does include a surprise concession. Eligible taxpayers will be able to elect to treat direct distributions from IRAs to charity made in January of 2011 as if they were made in 2010. There is as yet no guidance on how such an election should be made.

More to come

Future issues of Tax News You Can Use will examine wealth transfer and income tax planning opportunities for 2011 and 2012.

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